Supreme Court, U.S.
FILED
DEC 12 1985
JOSEPH F. SPANIOL, JR.
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85-1030 (1)

No. 85-

In the Supreme Court of the United States

OCTOBER TERM, 1985

IRVING AND CHARLOTTE RADOL, *et al.*,

Petitioners,

vs.

W. BRUCE THOMAS, *et al.*,

Respondents.

On Writ of Certiorari to the
United States Court of Appeals for the
Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

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105 PP

QUESTION PRESENTED

Can asset valuations prepared in accordance with routine industry standards and practices be material to target company shareholders in a tender offer?

PARTIES TO THE PROCEEDINGS

Petitioners are Irving and Charlotte Radol, A. James Ibold, Dwight C. Baum, the Crosset Charitable Foundation, Reuben A. Fishbein, Trustee, and Robert C. Utley, on behalf of themselves and all former shareholders of respondent Marathon Oil Company at the time of a tender offer for a majority of Marathon shares by respondent U.S. Steel Corporation in November 1981 and the subsequent March 1982 freeze-out going private merger when Marathon became a wholly-owned subsidiary of U.S. Steel. Petitioners are plaintiffs and were appellants below.

Respondents are W. Bruce Thomas, William R. Roesch, David M. Roderick, United States Steel Corporation, USS Inc., USS Holdings Company, USS Merger Sub, Inc., Goldman Sachs & Co., Marathon Oil Company, Harold D. Hoopman, Charles H. Barre, Elmer H. Graham, W.E. Swales, Jack H. Herring, Victor G. Beghini, Neil A. Armstrong, James A.D. Geier, J.C. Haley, J.N. Land, Jr., Raymond C. Tower, Robert G. Wingerter, and the First Boston Corporation. Respondents are defendants and were appellees below.

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Petitioners, Irving and Charlotte Radol, A. James Ibold, Dwight C. Baum, the Crosset Charitable Foundation, Reuben A. Fishbein, Trustee, and Robert C. Utley, on behalf of themselves and similarly-situated former shareholders of the Marathon Oil Company respectfully pray that a writ of certiorari issue to review the judgment of the Court of Appeals for the Sixth Circuit entered on September 13, 1985.

OPINIONS BELOW

The opinion of the court of appeals is reported at 772 F.2d at 244 and appears as Appendix A hereto. A companion opin-

ion decided the same day which treats the same subject matter and further explains the bases for the court's judgment is reported at 772 F.2d at 231 as *Starkman v. Marathon Oil Co.* (hereinafter "*Starkman*"), and appears as Appendix B. The opinion of the district court on motion for summary judgment is reported at 556 F. Supp. 586, and appears as Appendix C.

JURISDICTION

The judgment of the Court of Appeals was dated and entered on September 13, 1985. Jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), provides in pertinent parts:

> It shall be unlawful for any persons, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 14(e) of the Williams Act, 15 U.S.C. §78n(e), provides in pertinent part:

> It shall be unlawful for any person to make any untrue statements of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connec-

> tion with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

SEC Rule 10b-5, 17 C.F.R. §240.10b-5, provides in pertinent part:

> It shall be unlawful for any persons, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

A. Introduction

This is a class action under the federal securities laws, which arises out of the extinction of the rights of thousands of class members who held shares of the Marathon Oil Company when it was acquired by the United States Steel Corporation in a friendly tender offer in November, 1981 and subsequent freeze-out merger pursuant to proxy statement and prospectus dated February 8, 1982. The district court had jurisdiction under 28 U.S.C. §§1331 and 1337.

The major issue in the litigation is whether either or both of two extensive and expert valuations of Marathon's assets should have been disclosed to the shareholders at the time of the November, 1981 tender offer. One of the valuations was prepared by Marathon's investment advisor, and known as the First Boston Report. The other was prepared by Marathon

itself, and known as the Strong Report. Both were completed just before U.S. Steel's tender offer. Both were given by Marathon's management to U.S. Steel at the beginning of their negotiations. Both were concealed from the shareholders at the time of the tender offer.

The Sixth Circuit held that valuations of assets, including the First Boston and Strong Reports, are not material and thus need not be disclosed to shareholders under the federal securities laws unless they can be calculated with "substantial certainty." Since asset valuations must involve judgment the holding means that such valuations need never be disclosed. This is true even though the uncontradicted evidence at trial was that experts in the securities industry and the oil and gas industry regularly rely upon this type of valuation in making decisions whether to purchase or sell such assets. Similarly, the Sixth Circuit also held that the failure to disclose projections of earnings from such assets (which both Reports necessarily contained) can never violate Rule 10b-5 or the Williams Act, no matter how reasonable the bases for the projections. The district court gave what was in essence a directed verdict that the First Boston and Strong Reports should not have been disclosed. The Sixth Circuit affirmed on appeal, explicitly holding that a directed verdict was required.

The court below acknowledged that its standard was in direct conflict with one recently articulated by the United States Court of Appeals for the Third Circuit in *Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978 (3d Cir. 1984) (hereinafter sometimes "*Flynn*").

The holding below is also in direct conflict with the standard of materiality enunciated by this Court in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1978) (hereinafter sometimes "*TSC*"). There the Court explained that "an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important. . . ." *Id.*, at 449.

Indeed, just last Term, the Court reemphasized that the federal securities laws are premised upon full disclosure.

Schreiber v. Burlington Northern, Inc., 53 U.S.L.W. 4655 (U.S. June 4, 1985).

It was critical for Marathon shareholders to learn of the First Boston and Strong Reports at the time of the U.S. Steel tender offer. In the fall of 1981, Marathon's management faced a hostile tender offer at $85 per share from the Mobil Oil Company. To rescue itself, it agreed to a tender offer by a "white knight," U.S. Steel. Marathon's management agreed that U.S. Steel would obtain 51% of the Marathon shares pursuant to a tender offer for $125 per share, and the remaining 49% of the shares for debentures that, when issued, traded for $76 per share. Thus the "blended" price approximated $100 per share, and shareholders who did not tender at all received only $76 per share.[1]

The First Boston Report, completed just before these events, concluded that Marathon's net assets were worth between $188 and $225 per share. The Strong Report concluded that the net assets were worth $276 to $323 per share. Both demonstrated that Marathon's assets were worth substantially more than U.S. Steel's price.

Marathon's management gave U.S. Steel copies of the First Boston and Strong Reports, but did not disclose their existence or their contents to the shareholders. U.S. Steel's tender offer did not disclose the existence or contents of either Report. Instead, within a period of 17 days, Marathon's President wrote three letters to Marathon shareholders stating that the Mobil offer was "grossly inadequate" and was an attempt to "seize control of Marathon's assets at a fraction of their value," but that the U.S. Steel offer was fair, and therefore did represent the value of these assets.

Disclosing the First Boston or Strong Reports would have undermined the credibility of these letters with respect to the purported fairness of U.S. Steel's price. It would also have provided the shareholders with the information and tools

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1. U.S. Steel said it expected the debentures to trade at $86 per share, and therefore to yield a blended price of $106 per share.

necessary to evaluate the fairness of U.S. Steel's offer—information which U.S. Steel itself received. For shareholders not to receive these documents in these circumstances contravened the very purpose and function of the federal securities laws. Yet the Sixth Circuit held that, as a matter of law, both Reports need not be disclosed.

This Court should review this decision for three reasons: (1) the standard applied below conflicts directly with the Third Circuit's decision in *Flynn*, (2) the holding as to materiality is patently incorrect under this Court's definition of "materiality" set forth in *TSC*, and (3) the issue is a recurring one of national importance, because of the number of tender offers involving not only the oil and gas industry but many other industries in which asset valuations may exist at the time of a tender offer. A fair, coherent, and consistent standard needs to be articulated as to when such valuations should be disclosed. Since the uncontradicted evidence was that investment analysts and others routinely consider valuations like those involved here to be important in making business decisions, the Court's resolution of this important issue of federal law will guide target companies, tender offerors, and the investing public.

This petition describes the two asset valuations in question, and then explains their significance in the context of the U.S. Steel/Marathon Oil friendly tender offer.

B. The First Boston Report

In July, 1981, Marathon's President instructed its investment banker and financial advisor, First Boston Corporation, to prepare a valuation of Marathon's assets. The purpose was to show how a third party with no access to "inside" information, but a vast command of all public information, would value the company. The 82-page single-spaced document which resulted was designated "confidential" by Marathon and became known as the First Boston Report.

The Report concluded that Marathon had an underlying asset value, net of liabilities, of $11.1 to $13.2 billion. This was in contrast to the $3.7 billion equity value reflected in

Marathon's stock prices, meaning that Marathon was significantly undervalued in the marketplace. First Boston determined an asset value per share of $188 to $225 as of July, 1981, compared with the price at which the stock traded, which ranged from $76 in January, 1981 to $45 in May, 1981 to $80 in July and back to $48 in September.

Most of these assets were in oil and gas reserves. "[T]he bulk of Marathon's asset value lies in its proven domestic hydrocarbon reserve base." Specifically, Marathon's oil reserves in the United States, including proved petroleum reserves of 682.9 million barrels, amounted to 49% of its total assets.[2] The Yates Field in Texas, the "crown jewel" of Marathon's assets, in turn accounted for one-half of Marathon's United States reserves, or approximately 25% of Marathon's total assets. First Boston concluded that Marathon's interest in the Yates Field was worth from $2.7 billion to $3.6 billion. Thus, as First Boston set forth in its Report, this one asset alone—representing only 25% of Marathon's total assets—was worth as much as or more than *the total market value of the company's stock*:

> "[I]t is apparent that the value of the Yates holding alone approaches or exceeds the $3.7 billion market value accorded the Marathon equity by investors in recent trading."

First Boston repeatedly emphasized that its approach to valuation was "conservative." Indeed, the major subheading of the report was "*Conservative* Oil and Gas Valuations Based on Public Information." (Italics supplied.) In its section on Mar-

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2. The First Boston Report was conservative in focusing only on "proven" reserves and "probable" reserves, the latter of which were estimated at 20% of proven quantities, and then discounted 40% for implicit risk. (The net effect was to add 12% to the value of the proven reserves—60% of 20% = 12%) The First Boston Report assigned *no* value at all to a third, more speculative type of reserve known in the industry as "possible" reserves. Similarly, First Boston assigned no value to reserves which were in the process of exploratory drilling.

athon's natural gas reserves, it accepted for purposes of the report what it described as "low 'pessimistic' case factors."

First Boston applied its resources and expertise in the analysis of the data thus collected:

> "Behind our per barrel and mcf reserve values stands the output of First Boston's computer simulation model which incorporates implicitly parameters as to price, expenses, windfall, severance and other taxes, and other items. For natural gas reserves, we have also examined the impact of under-accelerated decontrol such as the Gramm Bill."

First Boston's methodology in valuing oil and gas reserves was to apply a "discounted cash flow approach with a 15% discount rate," meaning that future net cash flow was projected, and then "discounted" to arrive at a figure representing the present value of the ability to obtain such future earnings. For the Yates Field, three specific detailed cash-flow models were prepared, using a 7% inflation rate for oil prices. First Boston stated that this method of valuation was consistent with methods generally used in the industry. "[T]he values attributed to oil and natural gas reserves were based on our experience with representative petroleum properties. . . ."

Marathon's President testified that the discounted cash flow method was the standard method used in determining the current value of oil and gas properties. Similarly, U.S. Steel's Vice President for Corporate Strategic Planning testified that the "discounted" or "present value" method of valuing oil and gas reserves was the key factor in valuing oil and gas company securities. Marathon's world-wide oil and gas reserves[3] were each separately and carefully valued in this manner by First Boston for an aggregate value of oil and gas reserves of between $9.218 billion and $11.347 billion.

Marathon's President's description of his negotiations

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3. Including the Texas fields discussed above and Marathon reserves in Wyoming, Alaska, Louisiana, New Mexico, North Dakota, Utah, the Gulf of Mexico, the North Sea, the Celtic Sea, Libya, Abu Dhabi and Nigeria, the latter three accounting for a very small percentage of the reserves.

with U.S. Steel's President mirrored the data and analyses of the First Boston Report, which further demonstrated that the Report was a reliable reflection of what these two Presidents deemed "material" in the industry:

> "We talked about whether the output of the Bray [sic] field under the tax law in the UK would generate enough funds to justify the kind of price we were trying to get for the stock, when combined with the output from the Yates field, the refining and operating profits or losses, or however you want to look at it, what the variations were, and what the hazards were, how the windfall profit tax was going to impinge on the value of that barrel that is going to be produced out of one of the old fields. These are the kinds of things we talked about."

The First Boston Report at pp. 24-25 analyzed the North Sea Brae Field; at pp. 6-15, the value of the output from the Yates Field; at pp. 28-31, the refining and marketing operations, and at p. 15, the percentage classification of Marathon's "old oil," and the percentage impact of the three tiers of the windfall profit tax.

In addition, Marathon had more than $2.2 billion in "above ground" refining, marketing, and transportation assets, including four refineries in which Marathon had recently expended $750 million for expansion and upgrading. First Boston's conservative approach to valuation was further evident here, as it determined that comparable plants had recently been sold for a price based upon capacity per day which ranged between $1,000 and $4,000 per barrel per day. First Boston ascertained the replacement cost of Marathon's refineries at $6,000 to $7,000 per barrel per day. Nevertheless, First Boston valued the refineries at a range of $1,000 to $3,000 per barrel per day, lower than the market range.

C. The Strong Report

In July, 1981, simultaneously with instructing First Boston to prepare its Report, Marathon's President and its General Counsel instructed the Marathon department heads to

prepare an asset valuation using all information available to them. The 664 page document which resulted was also labeled "confidential" by Marathon, and became known as the "Strong Report" after J.F. Strong, the Marathon employee who organized it.

Marathon's general counsel requested Marathon's top level executives to obtain valuations of the assets within their areas of responsibility. A typical request stated:

> ". . . would you please furnish to me personally *your best opinion of the present market value of the Company's oil and gas reserves within your area of responsibility*, including, without limitation, proven reserves, probable reserves, possible reserves, and reserves which could be reasonably attributed to the Company's undeveloped acreage." (Italics supplied.)

Whereas First Boston concluded that the assets, net of liabilities, had a value range of $11.1 billion to $13.2 billion, the Strong Report concluded that the net assets had a value of $16.188 billion to $18.917 billion. Divided by the number of shares, this represented a per share value of $276 to $323.

The Strong Report explained its method for valuation as follows:

> "An internal evaluation of the assets of Marathon Oil Company has been completed as of June 30, 1981. . . . This appraisal was performed utilizing the 'Discounted Cash Flow' method on those assets which have sufficient data available. All other assets are appraised at current value, replacement or book value utilizing judgment decisions of the management of the respective companies."

Whereas the First Boston Report included only "proven" and "probable" oil and gas reserves, the Strong Report also included a third and fourth category, "possible" reserves and "reserves which could be reasonably attributed to the company's undeveloped acreage." And whereas First Boston used a steeper 15% discount rate for discounting the projected cash flow back to present value, the Strong Report used a

mixture of 12% and 15%. And the Strong Report used replacement cost as the basis for all of the above-ground assets (refining, marketing, and transportation), which yielded higher valuations than First Boston's approach. Nevertheless, these values represented the best determination by the high-level officers and employees of Marathon as to the value of Marathon's assets, prepared in the manner routinely used in the industry for valuing such assets. And the head of Marathon's Economics Department testified that all data provided by his department for the Strong Report were prepared by standard methods, free of any "optimistic" or other bias.

D. The Mobil Oil and U.S. Steel Tender Offers for Marathon

On October 30, 1981, three months after the First Boston and Strong Reports were commissioned, the Mobil Oil Company announced a hostile tender offer for 40 million Marathon shares at a price of $85 per share. Mobil proposed a subsequent going-private merger in which the remaining Marathon shareholders would receive a debenture also worth $85 for each Marathon share.

The next day, October 31, 1981, Marathon's Board of Directors met. First Boston presented its $188-$226 per share valuation. Mr. Strong presented the valuations of $276 to $323 per share contained in his Report. Based on these presentations and documents, the Marathon Board determined the Mobil offer to be "grossly inadequate." Marathon's President sent Marathon shareholders two letters, on November 2 and November 12, 1981, urging the shareholders to reject the Mobil offer and emphasizing the importance of the asset values in this determination of "gross inadequacy":

> "[Y]our board of directors is convinced that the Mobil offer is grossly inadequate **and does not represent the real values of the assets underlying your investment in Marathon.**" (Bold type in original.)

He did not disclose the existence of, or the per-share valuations or any other contents of, the First Boston or Strong

Reports. The second letter further stated: "We urge you to reject this attempt to seize control of Marathon's assets at *a fraction of their value*."[4] (Italics supplied.)

In June, 1981, U.S. Steel had internally stated that it was seeking to acquire "significantly undervalued ... energy" companies. On November 9, 1981, U.S. Steel telephoned Marathon to determine whether Marathon would be interested in a negotiated tender offer, a merger, or a purchase of Marathon's assets by U.S. Steel. The Presidents of U.S. Steel and Marathon met on November 10th. Marathon's President gave U.S. Steel's President a complete copy of the First Boston Report, and a summary of the Strong Report. U.S. Steel signed a three-page letter agreeing to keep these documents confidential and acknowledging them to contain "*material* information". The confidentiality agreement under which both of these documents were supplied by Marathon's management to U.S. Steel's management stated that "Marathon has endeavored to include in the Evaluation Material *all material information known to it which it believes to be relevant for the purposes of your investigation*." (Italics supplied.)

On November 18, 1981, Marathon and U.S. Steel reached an agreement under which U.S. Steel would offer to purchase 30 million Marathon common shares, or 51%, in a tender offer for $125 per share. Subsequently, U.S. Steel would implement a freeze-out merger to acquire the remaining 49% shares, issuing debentures which it stated would trade at $86 per share, but which actually traded on the issuance date at $76 per share, and were booked by U.S. Steel at this amount. Thus, a Marathon shareholder could, at best, expect to receive $125 for half of his or her shares, and $76 for the remainder, for a "blended" price of $100 per share. However, if the shareholder did not rush to tender, he or she would

4. On November 25, 1981, Mobil issued a revised takeover proposal involving $126 per share cash for the initial tender, and merger consideration designed to be worth $90 per share. Marathon obtained a preliminary injunction restraining Mobil from proceeding with its tender offer on the grounds such a merger would violate the antitrust laws.

be forced to accept the $76 debenture for all of his or her shares at the "back-end" of this "two-step" offer.

The merger agreement between Marathon and U.S. Steel was concluded on November 18, 1981. On November 19th, U.S. Steel mailed its offer to purchase 30 million shares to all Marathon shareholders. This offer did not disclose either the existence of or the valuations contained in either the First Boston Report or the Strong Report. Indeed, the offer was affirmatively misleading in creating the impression that the only material non-public information which had been provided by Marathon to U.S. Steel were certain earnings and cash flow projections which were disclosed in the Offer to Purchase.

On the same day, November 19th, Marathon's President again wrote to all Marathon shareholders, stating that the Marathon Board had determined the U.S. Steel price to be "fair," and urging the shareholders to tender. Seven days earlier, on November 12th, he had written to all shareholders that Mobil's $85 per share offer was "grossly inadequate" and did not represent the "real value of the assets." Now, U.S. Steel's blended price was urged as a price which did reflect the real value of those assets. The President's letter did not disclose the existence of or the valuations contained in the First Boston Report or the Strong Report, both of which would have seriously undermined the credibility of the rest of the letter. Shareholders were not apprised that First Boston, using conservative assumptions and facts of public record, had concluded that each Marathon share was worth between $188 and $226, nor that Marathon's own department heads had determined the company's net assets to be worth $276 to $323 per share using valuation methods routinely employed in the industry.

The Agreement signed between Marathon's management and U.S. Steel on November 18th also prohibited Marathon from providing any information to any other company which might have been willing to make an offer to purchase Marathon shares at a price which was higher than U.S. Steel's

price. At the time Marathon accepted U.S. Steel's offer, it had received an oral offer from Gulf Oil Corp., under which Gulf proposed to acquire Marathon at an average price of $120 per share.

E. Completion of the Takeover

Because of the "two-tier" structure of U.S. Steel's tender offer, whereby anyone who did not tender would be relegated to receiving only $76 for all of his or her shares, 53,880,360 or 92% of the Marathon shares were tendered. U.S. Steel purchased 30 million, or approximately 51%, and therefore had majority control. On February 8, 1982, defendants mailed to Marathon shareholders a Notice of Special Meeting of Shareholders and Proxy Statement, to announce the March 11, 1982 shareholder vote on the merger. The proxy statement was also a prospectus of U.S. Steel in connection with the proposed issuance of the notes to complete the merger of U.S. Steel and Marathon. This proxy statement revealed for the first time the existence of the First Boston and the Strong Reports, and the per share valuations contained in these reports.

On March 11, 1982, the merger was approved at a special meeting of Marathon shareholders. A two-thirds vote of all shares issued and outstanding was required to approve the merger; less than two-thirds of the shares which were not owned by U.S. Steel voted in favor of the merger.

All tendering shareholders received debentures worth $76 per share for their remaining shares not purchased by U.S. Steel in the tender offer. Persons who had not tendered initially received *only* the debentures worth $76 per share, significantly less than the $85 per share which the Marathon board stated on November 12, 1981 to be "grossly inadequate."

F. The Evidence For and Against Materiality and Reliability of the First Boston and Strong Reports

At trial, plaintiffs presented evidence for, and defendants presented evidence against, the materiality and reliability of

the First Boston and Strong Reports. Plaintiffs demonstrated that: (1) both Reports were presented to the Marathon Board on October 30, 1981, when it made its determination that Mobil Oil's tender offer was "grossly inadequate" and was an "attempt to seize control of Marathon's assets at a fraction of their value"; (2) both Reports were given by Marathon's management to U.S. Steel at the beginning of their negotiations; (3) both Reports were deemed by Marathon and U.S. Steel to contain "all *material* information known to [Marathon] which it believes to be relevant for the purposes of your [U.S. Steel's] investigation"; (4) the First Boston Report stated repeatedly it was using conservative data and assumptions, and Marathon's head of economics testified the Strong Report contained data prepared by standard methods, free from any optimistic bias; (5) Marathon's President testified that the "discounted cash flow" method of valuing the oil and gas reserves was standard in the industry; (6) U.S. Steel's Vice President Corry testified that the discounted cash flow method of valuing oil and gas reserves was the one primarily used by securities analysts in valuing oil and gas securities; (7) U.S. Steel's Assistant Comptroller Hernandez, who also participated in the negotiations, testified that the Strong Report would be "relevant" to a decision to "sell off Marathon's assets," which plan he testified U.S. Steel had under consideration; (8) U.S. Steel relied upon the Strong Report in January, 1982 in approaching bond rating agencies to approve the debentures, by showing that its price for Marathon was "reasonable" because "an internal valuation by Marathon placed a total value on its oil and gas reserves alone of over $13 billion"; (9) plaintiffs' expert in securities analysis (Torkelsen) testified that a reasonable investor would consider both Reports to be important, and (10) plaintiffs' expert in oil and gas valuations and in such investments (Murray) testified that the Strong Report was an "excellent, comprehensive, thorough analysis of the assets of Marathon," and "very important" to shareholders trying to make a decision of whether to dispose of Marathon stock, and further testified that the First Boston Report was a valuable study which "would have been ex-

tremely difficult for anyone else to compile, even though it is based on publi[illegible]mation."

Defenda[illegible]al attempted to attack the credibility of the Reports, and to show these documents had not been relied upon as heavily as plaintiffs contended. Most of their attacks were directed toward the Strong Report rather than the First Boston Report. Defendants claimed: (1) that the Strong Report was an unduly optimistic "sales" document, particularly with respect to its projection of the future price of oil and its use of replacement cost for valuing the marketing, refining, and transportation assets; (2) furthermore, that the Strong Report (but not First Boston's) contained data on unproved "possible" oil and gas reserves; (3) that U.S. Steel's Vice President Corry did not rely upon the Strong Report in evaluating Marathon because he thought it was "a trumped up piece of junk," and that he did not disseminate it to U.S. Steel's President or the U.S. Steel Board; (4) that the Marathon-U.S. Steel negotiations were actually based upon five-year earning and cash flow projections rather than upon the First Boston or Strong Reports, and (5) that the deposition of one plaintiff read at trial (Ibold) reflected that he did not think 30 year projections of net income and cash flow could be reliable. (He was not testifying, however, about valuations, nor in particular about the First Boston or Strong Reports.)

Thus, a genuine conflict of the evidence existed, which was for the factfinders to resolve. However, the district court's instructions took this issue from the jury, and the Sixth Circuit affirmed, holding that as a matter of law no disclosure to shareholders of either Report should have been made.

G. The District Court and the Sixth Circuit Decisions

The district court initially denied summary judgment to the defendants on the question whether the First Boston Report and the Strong Report could have been material to a reasonable shareholder, and should have been disclosed during the tender offer. Applying *TSC Industries, Inc. v. Northway, Inc., supra*, the court held:

> "It is conceivable that a 'reasonable shareholder' would have accorded the valuations 'actual significance' in his deliberations, even if disclosure would not have altered his decision." 556 F.Supp. 586, 594; A62.

At trial, however, the district court did an about-face, and gave what amounted to a directed verdict for defendants. The instructions, which plaintiffs challenged in the court below, are three:

> [1.] "Representations concerning future sales, projections, forecasts and the like only rise to the level of materiality when they can be calculated with substantial certainty."
>
> [2.] "Only disclosure of existing material facts is required. Economic forecasts are not."
>
> [3.] "A failure to make known a projection of future earnings is not a violation of Rule 10b-5."

The court of appeals affirmed these instructions, making it clear that a directed verdict for defendants was required:

> "[U]nder our decisions, the District Court should have ruled that the reports were not material and removed the issue from the jury." 772 F.2d at 253; A16.

The court held that, as a matter of law, there was no duty to disclose these Reports or their contents:

> "[W]e have held . . . that there was no duty to disclose the asset appraisals at issue here."[5] 772 F.2d at 253; A15.

The court of appeals held that asset valuations and projections of income should not be disclosed unless they "*are virtually as certain as hard facts.*" *Starkman*, 772 F.2d at 241; A44 (italics supplied). The court further stated that all predictions underlying asset valuations and projections must be

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5. In *Starkman* the companion decision to the case herein, the Sixth Circuit affirmed a grant of summary judgment which also ruled that the First Boston Reports and the Strong Reports did not have to be disclosed as a matter of law.

"substantially certain to hold" before disclosure should be made, and gave as an example only one type of prediction which could possibly meet this standard: "a fixed plan of corporate activity." *Id.*

Thus, there is a categorical standard in the Sixth Circuit under which no asset valuation need ever be disclosed. For every valuation, by its very nature, involves human judgments as to value and at least an implicit assumption about the future. No such judgment can ever be as certain as a "hard fact." No such judgment can ever be as "substantially certain to hold" as a "fixed plan of corporate activity." And no "projection of future earnings" ever need be disclosed to shareholders, no matter how reasonable or adequate its bases or to what extent the target management and tender offeror themselves relied on that projection. Under the jury instructions approved here, failure to disclose projections, including the projections such as the discounted cash flow method of the First Boston and Strong Reports at issue here, can never violate Section 10(b) or the Williams Act as a matter of law. And all of this is irrespective of the extent to which a reasonable investor would consider the valuations and projections significant in the making of his or her investment decisions.

REASONS FOR GRANTING THE WRIT

POINT I

There is a Conflict between the Third and the Sixth Circuits on Whether Asset Appraisals and Forecasts Like those Here Can be Material and hence Required to be Disclosed.

The Sixth Circuit's categorical rule that the federal securities laws never require disclosure of asset valuation or income projections to shareholders of the target company in a tender offer is in direct and acknowledged conflict with the rule enunciated by the Third Circuit in *Flynn, supra. Flynn* also involved the issue of when asset valuations should be disclosed to shareholders of the target company in a tender offer. The Third Circuit held as follows:

> "[T]oday we set forth the law for disclosure of soft information as it is to be applied from this date on. Henceforth, the law is not that asset appraisals are, as a matter of law, immaterial. Rather, in appropriate cases, such information must be disclosed. Courts should ascertain the duty to disclose asset valuations and other soft information on a case by case basis, by weighing the potential aid such information will give a shareholder against the potential harm, such as undue reliance, if the information is released with a proper cautionary note.[17]
>
> "The factors a court must consider in making such a determination are: the facts upon which the information is based; the qualifications of those who prepared or compiled it; the purpose for which the information was originally intended; its relevance to the stockholders' impending decision; the degree of subjectivity or bias reflected in its preparation; the degree to which the information is unique; and the availability to the investor of other more reliable sources of information.
>
> "17. Some courts have approved the release of appraisal values with an appropriate disclaimer. *See, e.g., South Coast*, 669 F.2d at 1269; *Alaska Interstate*, 402 F.Supp. at 573."
>
> 744 F.2d at 988.

The court below acknowledged that its holding was in conflict with *Flynn* (and the cases cited in *Flynn*), stating, "The Third Circuit has enunciated a different test. . . ." 772 F.2d at 242; A45. The Sixth Circuit rejected *Flynn's* holding, as follows:

> "By its very nature, this sort of judicial cost-benefit analysis is uncertain and unpredictable. . . ." *Id.*

It approved its own approach because it "focuses on the *certainty* of the data underlying the appraisal or projection." *Id.*; A46 (italics supplied). The court further emphasized that its holding would never require the disclosure of asset valuations and projections of income. *Id.*

Thus there are two different legal standards governing the disclosure of asset valuations of the target company to shareholders of that company in a tender offer. That conflict is particularly troubling in the context of what is supposed to function as a national securities market. Given the volume of tender offers[6] in which asset valuations of the target company may exist, it is particularly important that there be a uniform standard to guide the target company, tender offerors, and the shareholders in ascertaining what should be disclosed.

If the case at bar had been litigated in the Third Circuit, the jury would have been instructed to assess the factors set forth in *Flynn* above to determine the "materiality" and the defendants' duty *vel non* to disclose the First Boston and Strong Reports. It would have been instructed to assess the evidence (which on certain points was conflicting, as set forth on pp. 14-16 above) as to what facts were used to compile each of the reports; who prepared them, and what their qualifications were; why the reports were prepared; whether they were relevant to the shareholders' decision to tender; whether either report reflected bias or subjectivity; whether the information contained in either report was unique; and whether the Marathon shareholders could have received more reliable information from another source. The jury also would have been asked to determine whether disclosure, if required, should also have required an explanation or warning as to assumptions made in either report, so that shareholders could have better evaluated the reports' conclusions. Under the *Flynn* test, a reasonable jury could have concluded that both the First Boston and the Strong Reports (or alternatively, either of them) should have been disclosed under the federal securities laws by either Marathon or U.S. Steel, or by both.

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6. From 1981 through 1984, there were 228 cash tender offers in which the bidders in fact acquired some or all of the shares they sought. "The Economics of Any-or-All, Partial, and Two-Tier Tender Offers," A Study by the Office of the Chief Economist, Securities and Exchange Commission (April 19, 1985), Table 1a. Of the ultimate offers for these cases, only 49 (or 21%) were non-negotiated, *i.e.*, hostile, tender offers. *Id.*, Table 1b.

Under the Sixth Circuit standard applied in this case, however, the jury was instructed that such reports should not have been disclosed as a matter of law. The Sixth Circuit's opinions make it clear that henceforth no such valuation should ever be disclosed in the Sixth Circuit because none, by its intrinsic nature, can have the "substantial certainty to hold" as a "hard fact" or a "fixed plan of corporate activity."

The outcome of major litigation should not depend on which circuit is the forum for that litigation. And the national securities market should not have to contend with fundamentally different legal standards as to this important and recurring issue.

For the foregoing reasons, plaintiffs respectfully request that a writ of certiorari issue.

POINT II

The Standard of Materiality Applied by the Court below is Inconsistent with this Court's Decision in *TSC Industries, Inc. v. Northway, Inc.* and Therefore Erroneous.

The Sixth Circuit's decision constitutes legal error under this Court's decision in *TSC Industries, Inc. v. Northway, Inc.*, *supra*.

In *TSC*, this Court clarified and enunciated the standard of materiality applicable in the context of disclosures under the federal securities laws.[7] There the Court stated:

> "... An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. This standard is fully consistent with [*Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970)] general description of materiality as a requirement that 'the defect have a significant *propensity*

7. While the Court was faced in *TSC* with the definition of "material" for purposes of §14(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78n(a), the court below correctly determined that the same definition applies for purposes of §§10(b) and 14(e) and Rule 10b-5. 772 F.2d at 253; A14-A15.

> to affect the voting process.' It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

426 U.S. at 450 (italics in original; footnote omitted). Thus, the substantial likelihood is to be gauged in terms of how the investor would view the omitted factual information.

In dealing with the value of oil and gas companies, the principal asset involved is generally the company's reserves. Routinely these are valued by appraising what revenues those reserves will generate when the resources are pumped out of the ground, and then those future revenues are discounted to their present value. In appraising such assets, therefore, persons investing in oil and gas reserves (including energy companies, tender offerors, and securities investors) must and *routinely do* make reasonable determinations of such future events in order to value the properties involved.

The uncontested evidence in the record is that this is the practice generally used in the oil and gas industry for valuation of reserves and that the First Boston and Strong Reports were prepared in a manner consistent with the industry's practice.

President Hoopman of Marathon, for example, testified that "when oil properties change hands, in most instances it's done on a calculation of discounted cash flow. . . ." U.S. Steel's Vice President Corry testified that "a lot of securities analysts would always put out security analysts' reports, and they would usually go through the same exercise and say the present value of this company's reserves, X and Y."

Thus, the uncontradicted evidence was that, in fact, the oil and gas industry and its investors do consider the valua-

tion studies like the First Boston and Strong Reports to be important. The valuation appraisals in fact assume "actual significance to the reasonable investor." 426 U.S. at 450. And the disclosure of the appraisals "would have been viewed as having significantly altered the 'total mix' of information made available." *Id.*

Appropriate application of the materiality standard enunciated in *TSC* is reflected in *SEC v. MacDonald*, 699 F.2d 47 (1st Cir. 1983). There the First Circuit recently explained:

> "[I]nvestors regularly deal in probabilities and expectations, rather than certainties. The materiality of facts regarding a contingent future event is simply a function of the anticipated magnitude of the event if it occurs, discounted by the probability of its occurring. *See, SEC v. Texas Gulf Sulphur Co.*, 2 Cir., 1968, 401 F.2d 833, 849, *cert. denied*, 394 U.S. 976. . . . A 'reasonable, if speculative, investor' would consider information indicating even the possible occurrence of an event of magnitude to be important. *Id.* at 849-50. Here, the future event was sufficiently large to remain material even discounting for whatever uncertainty may be thought to have existed."

699 F.2d at 50. This approach properly takes into account the nature of the industry involved and its practices, as well as the actual informational needs of investors in that industry.

Yet the court below imposed a standard that is inconsistent both with *TSC*'s holding of what is "material" and with the general purpose of the federal securities laws to require *full disclosure* of important information. The Sixth Circuit stated in *Starkman* that its cases "firmly establish the rule that soft information such as asset appraisals and projections must be disclosed only if the reported values are *virtually as certain as hard facts*." 772 F.2d at 241; A44 (italics supplied). Thus, no matter how reasonable investors may be in considering these asset valuations significant, which is the standard enunciated in *TSC*, the Sixth Circuit would preclude their disclosure.[8]

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8. Viewed another way, in order to harmonize its standard with *TSC*, the court below would have to conclude that all investors who consider these asset valuations significant must be "unreasonable" as a matter of law.

The direct effect of the holding below, therefore, is to withhold from investors the most pertinent information available concerning the principal assets of oil and gas companies: their reserves. This directly conflicts with this Court's clear holding in *TSC*.

POINT III

The Inconsistency of the Decision below with this Court's Holding in *TSC Industries Inc. v. Northway, Inc.* and the Conflict between the Decision below and the Third Circuit's Opinion in *Flynn v. Bass Brothers Enterprises, Inc.* are the Direct Result of the Sixth Circuit's Misunderstanding of SEC Policy and Practice and of Certain Uncontested Facts in this Record.

The Sixth Circuit, in reviewing the pronouncements of the SEC, concluded in *Starkman* that the reports at issue here "contain estimates of probable and possible reserves, and the disclosure of this information was *actually prohibited* at the time of Steel's tender offer. . . ." 772 F.2d at 240; A43 (italics supplied). Yet, in *Flynn*, the court concluded that, "[A]t the time Bass Brothers was making its tender offer [in 1976], although courts did not generally require the disclosure of asset valuations, such disclosure was not prohibited." 744 F.2d at 986. The Sixth Circuit's view also is directly contrary to an official Release published by the SEC prior to the U.S. Steel tender offer. Moreover, the court's misstatement of SEC policy[9] is compounded by the court's clear factual misunderstanding as to the nature of the Reports, particularly the First Boston Report.

SEC policy and practice concerning the disclosure of asset valuations and projections have undergone a steady evolution toward more and more disclosure of so-called "soft" information over the past 9 years. The court in *Flynn* reviewed this progression in detail:

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9. Petitioners respectfully suggest that the Court may find it of assistance to request of the SEC an expression of its views on this subject.

"With respect to disclosure of projections of future earnings, the SEC in 1976 deleted future earnings from the list of examples of potentially misleading disclosures in the note which follows rule 14a-9.[15]

"More importantly, in 1978 the SEC issued a safe harbor rule for 'forward-looking' statements, such as future earnings, made in good faith. 17 C.F.R. §230.175 (1983). And with respect to asset valuations, the SEC in 1980 authorized disclosure of good faith appraisals made on a reasonable basis in proxy contests in which a principal issue is the liquidation of all or a portion of a target company's assets. See SEC Release No. 34-16833, Fed.Sec.L.Rep. (CCH) ¶24,117 (May 23, 1980), codified at 17 C.F.R. §241.16833 (1983). While SEC policy has not yet explicitly approved the disclosure of appraisal values when the target is to continue as a going concern rather than being liquidated, recent SEC promulgations herald a new view, more favorably disposed towards disclosure.

"15. *See* Securities Act Release No. 5699, Notice of Adoption of an Amendment to Rule 14a-9, etc. [1975-1976 Transfer Binder] CCH Fed.Sec.L.Rep. ¶80,461 (1976)."

744 F.2d at 986-987. The *Flynn* court also explained that "the initial prohibition of soft information [resulted from] the fear that potential *purchasers* of securities would be misled by overly optimistic claims by management. . . . An unintended by-product of such concern, however, was to keep valuable information from those shareholders who had to decide, within the context of a tender offer or merger, whether or not to *sell* their securities."[10] 744 F.2d at 987 (italics in original).

In this context of increasing allowance of disclosure of asset valuations and projections, the SEC issued Release No.

10. The irony of the illogical ruling below is that Marathon shareholders were given the soft information at the time of the merger, when they were purchasers of U.S. Steel's debenture, but not at the time of the tender offer, when they sold half their Marathon stock for cash.

33-6332,[11] dated August 6, 1981. In this Release, the Commission proposed revision to its Regulation S-K pertaining to disclosures to be made in documents filed with the SEC. The Release described "the present Commission practice" concerning the disclosure of probable and possible reserves.[12] Release No. 33-6332, p.29; A65. Specifically, the SEC stated that it was, in August 1981, "consistent with staff practices" to permit disclosure, with the staff's prior approval, of "reserves other than proven oil and gas reserves . . . [where it is shown] that the deletion of such reserve disclosure would render the document materially misleading. . . ." *Id.*

From this authoritative Release, it is clear that the Sixth Circuit made a significant, indeed critical, error in its understanding of SEC policy and practice. The *Starkman* opinion does not even mention Release No. 33-6332. In this case,[13] Petitioners cited and discussed that Release in their briefs to the Sixth Circuit, yet the court below merely referred to its discussion of materiality decided in *Starkman*. 772 F.2d at 252-253; A14-A15. The court did not discuss Release No. 33-6332.

The importance of the SEC's actual practice and policy at the time of the U.S. Steel tender offer cannot be understated. The underlying purpose of the federal securities laws is full disclosure of all material facts. *Schreiber v. Burlington Northern, Inc.*, 53 U.S.L.W. at 4655; *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963). Consistent with the Court's definition of material information in *TSC*, the Commission has recognized—and had recognized at the time

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11. The Release also bears nos. 34-18008, 35-22150, and 39-647. It is reproduced in Fed.Sec.L.Rep. (CCH) No. 926, Part II (Aug. 12, 1981). The discussion of "Item 102, Description of Property," contained in pages 28-30 of the Release, is set forth as Appendix D hereto.

12. The Sixth Circuit nowhere explained why defendants were not obligated to disclose the asset valuations at least to the extent of Marathon's *proven* reserves.

13. The same panel of three judges decided both cases on the same day, and both opinions were authored by the same Circuit Judge.

of the tender offer—that disclosure of estimates of reserves other than proved reserves can be made if required in order to prevent a filing from otherwise being materially misleading.[14]

Thus, in September 1982, the SEC staff was able to state in a Staff Accounting Bulletin that it had "for the past several years" actually suggested a form of disclosure of reserves other than proved reserves. Staff Accounting Bulletin No. 47, September 16, 1982, reproduced in 6 Fed.Sec.L.Rep. (CCH) ¶74,211, p.63,944. Indeed, the Bulletin expressly responds to the question, "what types of disclosures *will be permitted* by registrants who wish to indicate that some of their properties have value other than that attributable to proved reserves?" *Id.* (italics supplied). The "Interpretive Response" was:

> "The Office of Engineering has, for the past several years, suggested to registrants the following form of disclosure for undeveloped lease acreage:
>
> > 'In addition to proved reserves, the estimated (or appraised) value of leases or parts of leases to which proved reserves cannot be attributable is $xxx.'"

Id. This Bulletin confirms that, at the time of the tender offer, the Commission was not only not prohibiting the disclosure of probable and possible reserves, but in fact was even suggesting a form by which that disclosure could be made.

In addition to failing to take account of SEC policy and practice, the Sixth Circuit employed faulty logic. Apparently, the court reached the conclusion that the disclosure of probable and possible reserves was prohibited merely because the disclosure was not expressly required. This reasoning is clear from the language in *Starkman* that the disclosure was "only *permitted* since" the tender offer. 772 F.2d at 240; A43 (italics original).

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14. Indeed, both Rule 10b-5 and Regulation S-K set forth this general over-weaning principle. Where additional disclosure beyond the required minimum is necessary to prevent a document from being deceptive, that disclosure must also be made. *E.g., Zell v. Intercapital Income Securities, Inc.*, 675 F.2d 1041, 1044 (9th Cir. 1982); *Maldonado v. Flynn*, 597 F.2d 789, 796 n.6 (2d Cir. 1979).

The defect in this reasoning is plain: the Commission frequently will insist upon disclosure to prevent a filed document from being misleading even though the disclosure is not required in every case. As quoted above, the *Flynn* court recognized that such disclosure, although not generally required, "was not prohibited." 744 F.2d at 986. U.S. Steel itself acknowledged this in its comment to the SEC two weeks before the tender offer. There U.S. Steel stated in connection with Release No. 33-6332:

> "As the Commission is well aware, the non-disclosure of what were then only inferred reserves was the basis of the *Texas Gulf Sulphur* case."[15]

Letter, U.S. Steel to the SEC, October 30, 1981, Plaintiffs' Trial Exhibit 1110.

However, the SEC at the time of the U.S. Steel tender offer clearly *did* require the disclosure in documents filed with the Commission of probable and possible oil and gas reserves. SEC Rule 13e-3, 17 CFR §240.13e-3, and Schedule 13E-3, 17 CFR §240.13e-100, together command disclosure of any appraisal received from an outside party, which appraisal is materially related to a going-private transaction. Schedule 13E-3, Item 9. The Rule also requires disclosure of projections of revenues. Schedule 13E-3, Item 10. It was for this reason that the merger proxy statement and prospectus filed jointly by U.S. Steel and Marathon after the tender offer in fact finally disclosed the First Boston and Strong Reports. Thus, it is clear that, in the words of Section 13(e)(1) of the Securities Exchange Act of 1934, 15 U.S.C. §78m(e)(1), "the Commission deems [these appraisals and projections] to be material to a determination whether [the Marathon stock] should be sold."

Further, the Sixth Circuit's decision is premised upon a materially inaccurate characterization of uncontested facts. Of primary importance is the court's repeated misstatement

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15. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1969).

that the First Boston Report contained estimates of possible and potential reserves and that the estimates of those reserves and of Marathon's probable reserves were "a major component" of the Report.[16] 772 F.2d at 241; A43. In fact, contrary to the Sixth Circuit's understanding of the First Boston Report, that document did *not* include any appraisal of possible reserves or potential reserves at all. Further, the valuation of probable reserves was at most 12% of the proved reserves.[17] The Sixth Circuit nowhere explained why at least the proved reserves component of Marathon's assets, which equalled approximately 89% of the valuation of the reserves, should not have been disclosed.

Petitioners respectfully submit that, should this Court grant the instant Petition, the Court will conclude that the court below misunderstood SEC policy and practice and misapprehended the uncontested evidence concerning the nature of the Reports at issue. This, of course, is in addition to the erroneous standard applied below under this Court's decision in *TSC Industries, Inc. v. Northway, Inc.* and the conflict between the decision below and the correct application of *TSC* by the Third Circuit in *Flynn v. Bass Brothers Enterprises, Inc.*

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16. Another example of this clear miscomprehension of the report is: "The . . . First Boston report[] . . . contain[s] estimates of . . . possible reserves" (772 F.2d at 240; A43).

17. The probable reserves were calculated as 20% of the proved reserves and then discounted by 40%. Thus, the probable reserves were merely 60% of 20% (or 12%) of the proved reserves.

CONCLUSION

For all the foregoing reasons, Petitioners respectfully pray the Court grant a writ of certiorari to review the opinion and judgment of the United States Court of Appeals for the Sixth Circuit.

Respectfully submitted,

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December 12, 1985

CERTIFICATE OF SERVICE

I, David H. Weinstein, hereby certify that I am a member of the Bar of the Court, that I am one of the attorneys for petitioners on the foregoing Petition, and that three copies of the foregoing Petition were served on counsel for each respondent by United States mail this date by deposit of same in a United States post office or mail box, first class postage prepaid, addressed to counsel of record at their respective office addresses.

DATED: December 12, 1985 DAVID H. WEINSTEIN

Appendix A

No. 83-3598.

UNITED STATES COURT OF APPEALS, SIXTH CIRCUIT.

Argued Jan. 22, 1985.

Decided Sept. 13, 1985.

Irving and Charlotte RADOL, A. James Ibold, Dwight C. Baum, the Crossett Charitable Foundation, Reuben B. Fishbein, Trustee for Teri Fishbein Hecht, Beneficiary, and Robert C. Utley, on Behalf of Themselves and All Others Similarly Situated, Plaintiffs-Appellants,

v.

W. Bruce THOMAS, William R. Roesch, David M. Roderick, United States Steel Corporation, USS Inc., USS Holdings Company, USS Merger Sub, Inc., Goldman, Sachs & Co., Marathon Oil Company, Harold D. Hoopman, Charles H. Barre, Elmer H. Graham, W.E. Swales, Jack H. Herring, Victor G. Beghini, Neil A. Armstrong, James A.D. Geier, J.C. Haley, J.N. Land, Jr., Raymond C. Tower, Robert G. Wingerter, and the First Boston Corporation, Defendants-Appellees.

Jacob K. Stein [Lead Counsel], Paxton & Seasongood, Cincinnati, Ohio, Melvyn I. Weiss, argued, Milberg, Weiss, Bershad & Specthrie, New York City, Stanley R. Wolfe, Berger & Montague, P.C., Stewart Savett, Kohn, Savett, Marion & Graf, P.C., Philadelphia, Pa., for plaintiffs-appellants.

Murray Monroe, Cincinnati, Ohio, John L. Strauch [Marathon Oil], argued, Robert R. Weller, John M. Newman, Jr., Cleveland, Ohio, Richard S. Walinski, Toledo, Ohio, John W. Beatty, Cincinnati, Ohio, Richard J. Holwell [Lead Counsel], argued, Richard Reinthaler, New York City, William D. Ginn, Cleveland, Ohio, Henry T. Reath, Thomas Preston, Duane,

Morris & Heckscher, Philadelphia, Pa., David C. Greer, Dayton, Ohio, Michael P. Graney, Simpson, Thacher & Bartlett, Columbus, Ohio, James T. Griffin, Michael P. Mullen, William J. Raleigh, Chicago, Ill., Ronald S. Rolfe, Cravath, Swaine & Moore, New York City, N.Y., for defendants-appellees.

Before MERRITT and KENNEDY, Circuit Judges; and PECK, Senior Circuit Judge.

MERRITT, Circuit Judge.

This class action suit arises out of the fall, 1981 contest for control of Marathon Oil Company which ended in a two-stage merger of Marathon into United States Steel (Steel), one of the largest mergers in United States history. The first stage involved a tender offer by Steel for 51 per cent of Marathon's outstanding shares at $125 per share. The second stage was a "freezeout merger"—a merger in which the majority buys out the minority shareholders—with Marathon merged into Steel as a wholly owned subsidiary, and remaining Marathon shareholders receiving bonds worth approximately $76 per Marathon share. This suit is the consolidation of 13 separate actions challenging the two-step acquisition of Marathon by Steel as violative of the federal securities laws and state common law and fiduciary duty obligations. The three primary contentions underlying the various legal issues are that certain appraisals of Marathon's assets should have been disclosed to Marathon shareholders at the tender offer stage of the transaction, that the two-tier transaction with a second stage merger price lower than the front-end tender offer price was illegally coercive, and that Marathon's directors breached their fiduciary duty to the shareholders by structuring such a transaction in order to preserve their control over Marathon.

This action was heard before Judge Rubin in the Southern District of Ohio, and all issues were decided in favor of the defendants, some on summary judgment and others after trial before a jury. On appeal, the plaintiffs raise a large

number of essentially legal challenges to the proceedings in the District Court, but for the reasons set forth at length below, we reject these challenges and affirm the District Court's decision in all respects.

I. FACTUAL BACKGROUND

In October, 1981, Marathon was a widely held, publicly traded Ohio corporation with over 58 million shares held by over 35,000 stockholders. Marathon was a vertically integrated oil and gas company, conducting exploration, production, transportation, refining and marketing and research. From 1976 to 1980, Marathon's net revenues and profits advanced at average annual rates exceeding 15%, but the first half of 1981 brought lower worldwide demand for oil and a strengthened dollar, events causing a sharp reversal in Marathon's performance. Earnings per share plunged to $2.64 from $4.08 a year earlier, and during the June, 1981 quarter, Marathon's four U.S. refineries operated at only 58% of capacity. A. 2588, Def.Ex. 424.10.[1] The market price of a share of Marathon common stock, which had stood at $81 in November, 1980, fell to $45 in June, 1981. A. 2686, Def.Ex. 695.

Although Marathon's stock price had fallen during early 1981, the company held substantial long term oil and gas reserves, including the Yates Field in West Texas, one of the largest and most productive oil fields ever discovered, and along with a number of other oil companies, Marathon became a prime potential takeover target in the summer of 1981. In this threatening atmosphere, Marathon's top level management began preparations to defend against a hostile takeover bid. Harold Hoopman, Marathon's president and chief executive officer, instructed the company's vice presidents to compile a catalog of Marathon's assets. This document, referred to as the "Strong Report" or "internal asset evaluation," estimated the value of Marathon's transportation,

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1. Throughout this opinion, "A" refers to the appendix on this appeal, "Def. (Pl.) Ex." refers to defendants' (plaintiffs') exhibit below, and "T" refers to the trial transcript.

refining and marketing assets, its other equipment and structures, and the value of proven, probable and potential oil reserves as well as exploratory acreage. This report, discussed at greater length in *Starkman v. Marathon Oil Co.*, 772 F.2d 231, (6th Cir. 1985), estimated the present value of oil and gas properties based on highly speculative assumptions regarding the level of prices and costs expected to prevail as far as thirty to fifty years into the future, and was described by Hoopman and John Strong, his assistant who was responsible for combining materials received from the various divisions into the final report, as a "selling document" which placed optimistic values on Marathon's oil and gas reserves so as to attract the interest of prospective buyers and ensure that Marathon could either ward off a hostile takeover attempt or at the very least obtain the best offer available and avoid being captured at a bargain price.

The Strong Report valued Marathon's net assets at between $19 billion and $16 billion, a per share value of between $323 and $276. A similar report using identical methodology but based only on publicly available information (excluding, therefore, potential and unexplored acreage) was prepared in mid-July 1981 by the investment banking firm of First Boston, which had been hired by Marathon to assist in preparing for potential takeover bids. The First Boston Report was similarly described as a "presentation piece" to avoid a takeover or to maximize the price obtained in a takeover, and it placed Marathon's net asset value at between $188 and $225 per share.

Marathon's market value was far below these appraised values, however, and on October 29, 1981, Marathon closed at $63.75 per share. The next day, Mobil Oil Company announced its tender offer to purchase up to approximately 68% of outstanding Marathon common stock for $85 per share in cash. Mobil proposed to follow the tender offer with a going-private or freezeout merger in which the remaining shareholders of Marathon would receive sinking fund debentures worth approximately $85 per share.

On October 31, 1981, Marathon's board of directors met in a

day-long emergency session to consider Mobil's hostile tender offer. At this time, there were twelve members of Marathon's board, equally split between inside and outside directors. The inside directors were Hoopman and Marathon's five divisional vice presidents. The outside directors were N.A. Armstrong, former astronaut; J.A.D. Geier, the chairman of Cincinnati Milacron; J. Haley, vice president of Chase Manhattan Bank; R.G. Weingerter, chairman of LOF; R.C. Tower, president of FMC; and J.N. Land, a former investment banker then engaged in financial consulting. Haley was the only director absent from the October 30, 1981 meeting.

The meeting began with a presentation by inside and outside legal counsel explaining the possible adverse antitrust implications of the Mobil offer and reviewing the legal obligations of the board to act in the best interests of Marathon's shareholders. Representatives of First Boston then delivered a lengthy presentation in which they compared the premium over market price offered by Mobil and stated their opinion that this premium was at best modest compared with other recent oil company takeovers. First Boston presented the results of its asset valuation report, but cautioned that the values did not represent realistic market values, as evidenced by the large number of companies whose market value was far less than their appraised value, and also that liquidation value would be significantly less than appraised value because of the relative bargaining positions in a liquidation, which in any event was felt to be an unrealistic response to Mobil's tender offer because of the length of time required to secure shareholder approval of a liquidation. First Boston urged the board to take quick action to find an alternative merger partner in the time remaining for shareholders to withdraw their tenders to Mobil, because even with potential antitrust problems, First Boston thought Mobil's offer still capable of succeeding.

After this presentation by First Boston, John Strong, Hoopman's assistant, spoke briefly and handed out the executive summary to the Strong Report. He described the document as a catalog that would be used in trying to sell the

company to another bidder, and cautioned that there was very little correlation between the theoretical asset valuations and the market value of Marathon.

At the completion of these discussions, the outside directors met separately and unanimously determined to recommend that the board as a whole reject Mobil's offer, based on its potential illegality under the antitrust laws and the opinion of First Boston and the directors' own opinion that it was unfair to shareholders. The board as a whole then reconvened and unanimously agreed to recommend that shareholders reject Mobil's offer and authorized management to begin immediately the search for another potential bidder and also authorized counsel to file an antitrust suit seeking to enjoin Mobil from proceeding further with its bid.

On November 1, 1981, Marathon filed its antitrust suit against Mobil, *Marathon Oil Co. v. Mobil Corp.*, 530 F.Supp. 315 (N.D. Ohio 1981), and secured a temporary restraining order prohibiting Mobil from purchasing any additional Marathon shares. Marathon's board and senior management meanwhile speedily contacted all of the thirty to forty companies who were considered reasonable merger candidates, while simultaneously advising shareholders by letter to reject Mobil's bid as "grossly inadequate." Both the Strong and First Boston reports were presented to potential merger partners in an attempt to kindle interest in Marathon.

Representatives of Steel and Marathon first met on November 10, 1981, at which time Hoopman gave Steel president David Roderick a copy of the asset valuation reports. On November 12, board member Elmer Graham, Marathon's vice president for finance, delivered financial information, including five-year earnings and cash flow projections to Steel in Pittsburgh. Negotiations between Hoopman and Roderick ended on November 17 in an offer by Steel to purchase up to 30 million shares (about 51%) of Marathon stock for $125 per share in cash, to be followed by a merger proposal in which each remaining Marathon shareholder would receive one $100 face value, 12 year, 12½% guaranteed note per share of common stock.

On November 18, a formal meeting of Marathon's board was held to consider Steel's offer in light of competing, but more tentative, proposals from Allied Corporation and Gulf Oil Corporation. Allied's proposal was considered to be highly questionable, because it was premised upon Marathon's purchase of an Allied subsidiary at a greatly inflated price in order to give Allied the cash to bid $101-105 per share for a minority interest in Marathon. Gulf proposed to purchase 50% of the outstanding Marathon shares for $130-140 per share and then consummate a merger in which Marathon shareholders would receive securities worth $100-110 per share, but Marathon's counsel advised that a merger with Gulf would pose antitrust problems equal to if not more severe than those raised in Marathon's own antitrust suit against Mobil. First Boston estimated that since current market interest rates were then in the 18 to 20% range, the second stage notes offered in Steel's proposal would sell for approximately $86 per share, yielding an average price, with the first stage tender offer at $125 per share, of $106 per share. First Boston then compared the 76.6% premium over market offered by Steel with other recent takeover premiums, showing that the premium offered by Steel greatly exceeded the average premium in recent control transactions. First Boston recommended that the board accept Steel's bid.

Steel's offer was communicated by Roderick over a conference telephone call to the entire Marathon board, and was offered on a take-it-or-leave-it basis, to remain open for one day. After Roderick's call, the board discussed Steel's offer, and outside director Land asked if there were any severance agreements or "golden parachutes" granted to Marathon's senior management in a side agreement. Hoopman answered that Steel had agreed only to cash out Marathon employee stock options held by the officers and upper level management at the expected average price offered by Steel to other Marathon shareholders of $106 per share, and that Steel had requested that the present Marathon board be kept intact. After this brief discussion, the directors were polled indi-

vidually, and voted unanimously in favor of recommending that the shareholders accept Steel's offer.[2]

Steel mailed its tender offer on November 19, 1981, and simultaneously filed a Schedule 14D-1 with the SEC, as required by Rule 14d-3, 17 C.F.R. § 240.14d-3. Steel's tender offer specifically stated that the tender offer was the first step in "United States Steel's proposed acquisition of the entire equity interest" in Marathon, and described the terms of the second stage bond exchange. Def.Ex. 233, A. 2222, 2331-32. Hoopman sent a letter to Marathon's shareholders on November 19 in which he similarly described the two-tier transaction and recommended that shareholders accept Steel's tender offer. Def.Ex. 382, A. 2353. Marathon's Schedule 14D-9 attached to Hoopman's letter informed the shareholders of Gulf's proposal (describing Gulf anonymously as a "major oil company") and stated that this proposal had not been accepted because of anticipated antitrust problems. *Id.* Neither Steel's tender offer materials nor Hoopman's letter and attached Schedule 14D-9 revealed the existence of the Strong and First Boston reports and neither discussed Marathon's net appraised value, but Steel's tender offer did disclose that Steel had access to net income and cash flow projections for Marathon which were not publicly available, and those figures were set forth. Def.Ex. 233, A. 2228.

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2. The description of the October 31 and November 18 board meetings is drawn from Armstrong's testimony, T. 1811-1856, A. 758-800; Hoopman's testimony on cross, T. 830-36, A. 356-62; and the minutes of Marathon board meetings, Def.Ex.'s 218-220, A. 1941-69.

In the final agreement, Marathon also granted U.S. Steel an option to purchase up to 10,000 shares of Marathon common stock for $90 per share, and an option to purchase Marathon's interest in the Yates oil field for $2.8 billion if U.S. Steel's tender offer failed and another corporation succeeded in acquiring a majority interest in Marathon. On November 24, 1981, Mobil sued Marathon, U.S. Steel and directors of Marathon, seeking to enjoin the U.S. Steel tender offer. On December 23, 1981, this court invalidated both the stock and Yates Field options as "manipulative devices" under 14(e) of the 1934 Exchange Act, 15 U.S.C. § 78n(e), and ordered that the U.S. Steel tender offer be kept open for a reasonable time. On remand, the District Court set a withdrawal deadline for the U.S. Steel offer of midnight, January 6, 1982 (the original withdrawal date stated in the offer was December 17, 1981). *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981).

After Steel's tender offer was announced, the market price of Marathon stock rose, and fluctuated between $100 and $105 per share from November 19 until December 7. Def.Ex. 695, A. 2688-89. Mobil modified its offer in response to Steel's competing bid to provide for the purchase of 30 million shares at $126 per share, to be followed by a transaction in which the remaining shares would be exchanged for various securities to be valued at about $90 per share, and Mobil's offer remained open until enjoined on November 30 on the ground that it entailed probable antitrust violations. *Marathon Oil Co. v. Mobil Corp.*, 530 F.Supp. 315 (N.D. Ohio), *aff'd*, 669 F.2d 378 (6th Cir. 1981), *cert. denied*, 455 U.S. 982, 102 S.Ct. 1490, 71 L.Ed.2d 691 (1982). After this court invalidated both the stock and Yates Field options originally promised to Steel as manipulative devices under Section 14(e) of the Williams Act in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981), the withdrawal date on Steel's tender offer was set at January 6, 1982. Between the original withdrawal deadline of December 7 and January 6, 1982, Marathon stock traded at between $88 and $82 per share. Def.Ex. 695, A. 2688-89. By this latter date, a total of over 53 million shares, or 91.18% of the total outstanding had been tendered to Steel, and Steel purchased the promised 30 million shares on a pro rata basis on January 7.

On February 8, 1982, a proxy statement was sent to the remaining Marathon shareholders announcing a March 11, 1982 shareholder meeting at which the merger with Steel would be consummated if approved by two thirds of the Marathon stockholders, as required by Ohio law.[3] The proxy statement discussed the Strong and First Boston appraisals at

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3. Ohio Revised Code 1701.78(F) provides in pertinent part:

> The vote required to adopt an agreement of merger or consolidation at a meeting of the shareholders of a constituent domestic corporation is the affirmative vote of the holders of shares of that corporation entitling them to exercise at least two-thirds of the voting power of the corporation on such proposal or such different proportion as the articles may provide, but not less than a majority, and such affirmative vote of the holders of shares of any particular class as is required by the articles of that corporation.

some length, as is required in freezeout mergers by Rule 13e-3, 17 C.F.R. § 240-13e-3, warning, however, that the First Boston Report "should not be regarded as an independent evaluation or appraisal of Marathon's assets," and that the two reports were not "viewed by Marathon's Board of Directors as being reflective of . . . per share values that could realistically be expected to be received by Marathon or its shareholders in a negotiated sale of the Company as a going concern or through liquidation of the Company's assets." Def.Ex. 756, A. 2707-08.

On March 11, 1982, the special shareholder meeting was held, and the shareholders approved the merger with approximately 55% of the non-Steel Marathon shareholders voting for the merger, 20% voting against the merger, and 25% abstaining or not voting. A. 3525, Doc. 147. Marathon stock had traded at between $76 and $73 from the January 6 purchase date to the date of the shareholder meeting, indicating that the market eventually valued the bonds received in the merger at roughly $10 per share less than was forecast by First Boston.

II. SUMMARY OF PROCEEDINGS BELOW

The present class action suit represents the consolidation of thirteen separate actions by former Marathon shareholders asserting claims against Marathon, Steel, their directors (as of November, 1981) and investment bankers. The plaintiff class consists of two subclasses: Marathon shareholders who owned stock on November 19, 1981 and did not tender to Steel; and those who did tender to Steel. The plaintiffs presented claims under the federal securities laws and alleged state common law fraud and breach of fiduciary duty. Of these various claims, there are five substantive issues involved in this appeal, and we briefly summarize the treatment of these issues below before discussing our disposition of each in more detail.

On February 2, 1983, Judge Rubin granted defendants' motion for summary judgment on all of the plaintiffs' federal

securities law claims except the claim that the failure of the Marathon and Steel defendants to disclose the Strong and First Boston Reports in the tender offer materials violated Section 10(b) of the Securities and Exchange Act of 1934 (the Exchange Act), 15 U.S.C. § 78j(b), SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, and Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e).[4] Plaintiffs claimed that the failure to disclose these documents in the tender offer materials constituted the omission of material facts necessary to make the other statements

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4. Section 10(b) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 14(e) provides, in pertinent part:

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commece, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

made not misleading. In *Radol v. Thomas*, 556 F.Supp. 586, 593-94 (S.D. Ohio 1983), the District Court ruled that under the definition of materiality set forth in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), the issue of whether the Strong and First Boston asset appraisals were material facts was a question "best left to a jury." In answer to questions 1 and 2 of the special interrogatory, the jury found unanimously that the omission of these reports from the tender offer materials distributed on November 19, 1981, did not violate the federal securities laws. T. 2667, A. 1053.

The District Court entered summary judgment for the defendants on plaintiffs' claim that the tender offer materials constituted proxy solicitation because they represented the tender offer and second stage merger as a unitary transaction and violated Section 14(a) of the Exchange Act because they failed to comply with the proxy disclosure rules.[5] Judge Rubin reaffirmed the view (as expressed in his decision denying plaintiffs' motion for a preliminary injunction) that "a tender offer and merger are distinct acts with separate consequences toward which the securities laws and SEC Rules are directed in their regulatory schemes," and that references to the second stage merger in the tender offer materials were made in compliance with SEC rules governing tender offers and "were not the equivalent of solicitations for the merger which would call forth application of the full panoply of the proxy rules." 556 F.Supp. at 591 (quoting *Radol v. Thomas*, 534 F.Supp. 1302, 1314 (S.D. Ohio 1982)).

On the final federal securities claim at issue on this appeal, the District Court ruled that the two-tier merger of

5. Section 14(a) provides:

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 781 of this title.

Marathon and Steel did not constitute market "manipulation" in violation of Section 10(b) of the Exchange Act or Section 14(e) of the Williams Act. 556 F.Supp. at 589-90. Judge Rubin observed that although the disparity between the front-end tender offer price offered by Steel and the back-end merger price did place pressure on Marathon shareholders to accept the tender offer, all tender offers are to some extent coercive, but the two-tier tender offer here did not "circumvent the natural forces of market demand" and did not discourage competing offerors and was therefore not "manipulative" under our interpretation of the term in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981).

The District Court refused to grant summary judgment for the defendants on plaintiffs' state law claim that Marathon's board violated their fiduciary duty to Marathon's shareholders by structuring a coercive two-stage transaction and consummating the merger at an unfair price, by failing to disclose the Strong and First Boston reports and other material information, and by cashing out their stock options at terms that were unavailable to other Marathon shareholders. A. 3316-18, 3321-22. The jury subsequently unanimously found that Marathon's directors had not breached their fiduciary duties to Marathon shareholders. A. 2667.

The District Court, however, entered summary judgment for Steel on plaintiffs' fiduciary duty claims, finding that Steel's involvement as a fiduciary was only as a majority shareholder of Marathon after the tender offer and only with respect to consummation of the second stage merger. Judge Rubin held that under Ohio law, a dissenting minority shareholder's sole remedy to redress his dissatisfaction with a freezeout merger is the statutory appraisal action provided by O.R.C. § 1701.85(A), provided that the merger is authorized by statute. A. 3318.

III. DISCUSSION: FEDERAL SECURITIES ISSUES

A. Duty to Disclose the Strong and First Boston Appraisals

Rule 13e-3(e), 17 C.F.R. § 240.13e-3(e), requires the dis-

closure of certain information set forth in Schedule 13E-3, 17 C.F.R. § 240.13e-100, in freezeout merger proxy statements. Item 9 of Schedule 13E-3 requires that a summary of any asset appraisal prepared in connection with such a merger must be furnished, and the summary must describe the methods, results and underlying assumptions of the appraisal. Steel complied with this rule by describing the Strong and First Boston reports in the second stage merger proxy statement. Plaintiffs contend, however, that such disclosure should also have been made in the tender offer materials distributed to shareholders by Marathon and Steel, and that the failure to disclose these reports violated Section 10(b) of the Exchange Act, Rule 10b-5, and Section 14(e) of the Williams Act because it constituted an omission of material facts necessary to make not misleading other affirmative statements made in the tender offer materials.

On appeal, plaintiffs particularly challenge the trial court's jury instructions on materiality and the duty to disclose these reports. The disputed instructions state:

> An omitted fact is material if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to tender his stock.
>
> Only disclosure of existing material facts is required. Economic forecasts are not.
>
> A failure to make known a projection of future earnings is not a violation of the Federal Securities law.

T. 2647-48, A. 1045-46.

In *Starkman v. Marathon Oil Co.*, 772 F.2d 231, (6th Cir. 1985), we have reaffirmed our adherence to the basic rule established by our prior decisions that tender offer materials must disclose soft information, such as these asset appraisals based upon predictions regarding future economic and corporate events, only if the predictions underlying the appraisal are substantially certain to hold. The Supreme Court's test for materiality as set forth in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 450, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976), is whether there is a "substantial likelihood that, un-

der all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder." The District Court's instructions to the jury accurately stated this general test for materiality and the specific rule in this circuit governing the duty to disclose asset appraisals, and we have, in any event, held in *Starkman* that there was no duty to disclose the asset appraisals at issue here.

Indeed, if there was an error below on this issue, it was in allowing it to reach the jury. There is no other reported decision sending the materiality of an asset appraisal to the jury; every such decision involving an asset appraisal has held that there was no duty to disclose the appraisal.[6] Judge Rubin ruled that the Strong and First Boston reports were not immaterial as a matter of law because "[i]t is *conceivable* that a 'reasonable shareholder' would have accorded the valuations 'actual significance' in his deliberations, even if disclosure would not have altered his decision." *Radol v. Thomas*, 556 F.Supp. 586, 594 (S.D. Ohio 1983) (emphasis supplied). But the Supreme Court in *TSC Industries v. Northway*, 426 U.S. at 445-48, 96 S.Ct. at 2130-32, specifically reversed the court of appeals' definition in that case of material facts as all those which a reasonable shareholder *might* consider important, a definition which is essentially identical to Judge Rubin's ruling that the Strong and First Boston reports could be found to be material because a reasonable shareholder *conceivably* could consider them important. The purpose of the more stringent "substantial likelihood" test for materiality is to lessen the uncertainty facing corporate officials in determining what must be disclosed while preserving shareholders' access to all truly factual information. Even with the correct instructions on materiality, sending the issue to the jury on the basis of an incorrect application of the test for materiality introduces great uncertainty regarding a particular jury's view

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6. See the discussion in *Starkman v. Marathon Oil Co.*, 772 F.2d 231, (6th Cir. 1985), and the compilation of cases in *Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978, 986, 988 (3d Cir. 1984).

of "substantial likelihood," and under our decisions, the District Court should have ruled that the reports were not material and removed the issue from the jury.

B. Failure to Comply with the Proxy Rules

Plaintiffs claim that since the tender offer and the merger were viewed and represented by Steel and Marathon as a "unitary transaction," Marathon and Steel's tender offer materials constituted solicitations of shareholder consent to the proposed merger and should have contained all the information required to be included in a proxy statement under Section 14(a) of the Exchange Act. Relying on recent law review commentary,[7] plaintiffs argue that the two-tier tender offer put the typical Marathon shareholder in a position where he had to assume that if he tendered, he would virtually assure Steel's ability to consummate the merger, and that shareholders thus should have received all the information needed to evaluate the merger prior to the deadline tendering. The only judicial authority adduced in support of the plaintiffs' position is Judge Learned Hand's ruling in *SEC v. Okin*, 132 F.2d 784, 786 (2d Cir. 1943), that "writings which are part of a continuous plan ending in solicitation and which prepare the way for its success" are subject to the SEC's power to regulate proxy solicitations.

In rejecting this claim on the defendants' summary judgment motion, Judge Rubin correctly ruled that "a tender offer and subsequent merger are distinct acts with separate concerns toward which the securities laws and SEC rules are directed in their regulatory schemes," and that it was "entirely appropriate to consider each step in such a transaction separately." *Radol v. Thomas*, 556 F.Supp. 586, 591 (S.D.Ohio 1983). Steel complied with Rule 14d-3, 17 C.F.R. § 240.14d-3,

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7. Plaintiffs rely on Brudney and Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 Harv.L.Rev. 297, 330-40 (1974), and Brudney and Chirelstein, *A Restatement of Corporate Freezeouts*, 87 Yale L.J. 1354, 1361-62 (1978), where the authors argue that two-tier tender offers involving a second stage merger at a lower price than the front end tender offer are inherently coercive and should be prohibited.

by filing a Schedule 14D-1 with the Commission which disclosed the basic terms of the proposed merger with Marathon, as required by Item 5(a) of 17 C.F.R. § 240.14d-100. As the target, Marathon complied with Rule 14e-2, 17 C.F.R. § 240.14e-2, by sending a letter to its shareholders recommending acceptance of Steel's offer and describing the two-stage plan, and Marathon also complied with Rule 14d-9, 17 C.F.R. § 240.14d-9 by filing a Schedule 14D-9 with the Commission which described the basic terms of the merger. Both Steel and Marathon therefore complied with the specific disclosure requirements which apply to tender offers.

Requiring compliance with the proxy rules, in particular Rule 14a-9, 17 C.F.R. § 240.14a-9, or the specific freezeout merger proxy disclosure requirements in Rule 13e-3, 17 C.F.R. § 240.13e-3, in the tender offer stage of a two-tier transaction of this sort would be unfair because it would subject the tender offeror and target to the risk of liability for violating Section 5 of the Securities Act of 1933, 15 U.S.C. § 77e, by making an "offer to sell" securities prior to filing a registration statement for the securities.[8] In Securities Act Release No. 33-5927, *reprinted in* 3 Fed.Sec.L.Rep. (CCH) ¶ 24,284H (April 24, 1978), the Commission stated that the Section 5 "jumping the gun" prohibition would not apply to disclosure of a proposed second stage merger in tender offer materials as required by Schedule 14D-1, because to rule that such disclosure constituted an offer to sell would not further the policies of the 1933 Act and would be inconsistent with the Williams Act policy of requiring such information in order to provide full disclosure to investors confronted with an investment decision in the context of a tender offer. However, the Commission also warned that disclosure at the tender offer stage should not go beyond that specifically required by the Williams Act and the tender offer rules, and that "statements which are not required by the Williams Act may constitute an 'offer to sell' the securities to be exchanged in the

8. The securities involved here are the bonds to be exchanged for remaining Marathon shares in the second stage merger.

subsequent merger and, in the absence of a registration statement filed with the Commission at the commencement of the tender offer, may constitute a violation of Section 5 of the 1933 Act." 3 Fed.Sec.L.Rep. at 17,754. The plaintiffs' proposed extension of the comprehensive proxy statement disclosure requirements to the tender offer stage of a two-tier transaction thus risks placing the board in a completely untenable position in which liability attaches under the proxy rules for too little disclosure and under the 1933 Act for too much disclosure, a result we are unwilling to endorse. *Accord Sheinberg v. Fluor Corp.*, 514 F.Supp. 133, 137 (S.D. N.Y.1981); *American General Corp. v. NLT Corp.*, [1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 98,808, at 94,142 (S.D.Texas July 1, 1982).

In addition, unlike *SEC v. Okin*, 132 F.2d at 786, where Judge Hand found that the Commission "would be powerless to protect shareholders" from misleading letters concerning an ongoing proxy solicitation sent in preparation for a soon-to-follow competing solicitation unless the letters were themselves held to be proxy solicitations, the Commission has set forth disclosure requirements for tender offers, and there are sound policy reasons for treating tender offers differently, with respect to the volume and content of required disclosure, than proxy statements.

Contrary to the plaintiffs' assumption, an individual shareholder does not assure the success of the second stage merger by choosing to tender in the first stage. Rather, the merger occurs only if the tender offer succeeds, and the success of the tender offer is determined by shareholders' collective valuation of the premium offered in relation to other competing offers (here, Mobil's outstanding tender offer). In the tender offer context, the market plays an important role in providing shareholders with information regarding the value of the target firm, and target management has an incentive to broker the best deal for shareholders and provide favorable, optimistic information to prospective bidders—precisely the kind of information the plaintiffs say was contained in the Strong and First Boston reports and precisely that which

majority shareholders have an incentive to keep from the minority in an unfair freeze-out merger. The more extensive legal disclosure requirements which apply to freeze-out merger proxy statements are therefore justified by the fact that the law has given the majority the power to foreclose the ownership rights of the minority and has thereby eliminated the market as a correcting mechanism, leaving minority shareholders with only the option of dissent and appraisal, an option which cannot rationally be exercised unless the majority is compelled to make full disclosure regarding appraisals, earnings projections and other information that sheds light on the value of the firm. *Cf.* Toms, *Compensating Shareholders Frozen Out in Two-Step Mergers*, 78 Colum.L.Rev. 548, 554-60 (1978) (observing how the negotiating position of management in a unitary merger differs fundamentally from that of the corporation's individual shareholder in a tender offer).

For these reasons, neither Steel nor Marathon had a duty to comply with the proxy rules in their tender offer statements.

C. The Two-Tier Tender Offer as Manipulation Under the Federal Securities Laws

In alleging that the two-tier, front-end-loaded acquisition of Marathon by Steel was a coercive and manipulative device, in violation of Section 14(e) of the Williams Act, Section 10(b) of the Exchange Act, and Rule 10b-5, plaintiffs have directly attacked the structure of this transaction as coercive, and have neither alleged below nor argued in this appeal that the two-tier transaction was not fully disclosed in Steel and Marathon's tender offer materials or that shareholders were in any manner deceived as to the nature of the transaction. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477-79, 97 S.Ct. 1292, 1302-04, 51 L.Ed.2d 480 (1977), the Supreme Court held that allegations of deception or nondisclosure were essential to state a cause of action under Section 10(b). Based in large part on the interpretation of "manipulative" in *Santa Fe Industries*, and also on its reading of the legislative history of

the Williams Act, the Court recently ruled in *Schreiber v. Burlington Northern, Inc.*, ____ U.S. ____, 105 S.Ct. 2458, 2465, 86 L.Ed.2d 1 (1985), that without misrepresentation or nondisclosure, Section 14(e) of the Williams Act has not been violated, thereby rejecting this court's previous analysis in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (1981). Since the plaintiffs have failed to allege nondisclosure or misrepresentation of the two-tier transaction, but have instead attacked its structure, they have failed to state a claim under either Section 10(b) (and Rule 10b-5) or Section 14(e) and we affirm the District Court's entry of summary judgment for the defendants on this issue.

IV. STATE LAW ISSUES

A. Breach of Fiduciary Duty by Marathon's Directors

Plaintiffs initially argue that the District Court erroneously granted summary judgment on their claim that in structuring the coercive two-tier acquisition—including the intentional establishment of an unfairly low second stage price—Marathon's directors breached their fiduciary duty to the Marathon shareholders. The record, however, reveals otherwise. Judge Rubin specifically charged the jury that plaintiffs' claims included breach of fiduciary duty "by entering into an acquisition of Marathon by U.S. Steel on terms which were unfair to the shareholders of Marathon, and in particular to those shareholders who did not tender their shares to U.S. Steel." T. 2648, A. 1046. Moreover, the court's opinion denying the Marathon defendants' motion for summary judgment on the breach of fiduciary duty claim repeatedly characterizes that claim as revolving around "the Marathon directors' negotiation and approval of the structure and details of the two-step transaction . . . a transaction which was, allegedly, inherently unfair." A. 3321-22.

Having allowed the issue to reach the jury, Judge Rubin gave the following charge on breach of fiduciary duty:

> I do instruct you that officers and directors of a

corporation occupy a fiduciary relationship to the corporation and to its shareholders.

A fiduciary must exercise the utmost good faith, and he must give undivided loyalty. He must be scrupulously honest.

The exercise of the care, skill and diligence of a man of ordinary prudence dealing with his own property as a general rule fulfills the duty of a fiduciary.

In dealing with shareholders, a corporate officer or director must disclose to them all material facts.

A fiduciary, however, is not a guarantor or insurer. He is not liable for mistakes in judgment made in good faith.

The fiduciary duty is not breached unless the directors committed fraud, or intentionally acted contrary to the best interest of the corporation and the shareholders.

T. 2649-50, A. 1047-48.

On appeal, plaintiffs argue that the District Court erred in instructing the jury that Marathon's directors violated their fiduciary duty to the shareholders only if they committed fraud or intentionally acted contrary to the best interest of the shareholders. Plaintiffs contend that the directors were not entitled to this instruction because they were under a conflict of interest due to Steel's assurance that the present board would be continued intact and Steel's agreement to cash out stock options held by upper-level management at the expected average price in the two-tier deal.

We must look to Ohio for the substantive law on this question, and in Ohio as in every other state, the long established principle is that directors of a corporation have an obligation to the corporation which is in the nature of that of a fiduciary. *Ohio Drill & Tool Co. v. Johnson*, 625 F.2d 738, 742 (6th Cir. 1980); *Nienaber v. Katz*, 69 Ohio App. 153, 43 N.E.2d 322 (1942); 12 Ohio Jur.3d § 420, at 70-72 (1979). A director's obligation to the corporation includes two separate duties: the duty of loyalty and the duty of care. *See* ALI, Principles of Corporate Governance: Analysis and Recommendations, In-

troductory Note, Part IV, at 4 (Tent.Draft No. 4, April 12, 1985) (quoting *The Corporate Director's Guidebook*, 33 Bus.Law. 1591, 1599-1600 (1978) on the distinction between the duty of loyalty and the duty of care). The Ohio formulation of these duties was codified in 1984 in O.R.C. § 1701.59(B), and under the duty of loyalty, a "director shall perform his duties as a director . . . in good faith, in a manner he reasonably believes to be in the best interests of the corporation," while under the duty of care, a director must perform his duties "with the care that an ordinary prudent person in a like position would use under similar circumstances."

Moreover, in evaluating a director's compliance with the duty of care, Ohio courts adhere to the "business judgment rule," and will not inquire into the wisdom of actions taken by the directors in the absence of fraud, bad faith or abuse of discretion. 12 Ohio Jur.3d § 415, at 63-64 (1979); *Ohio National Life Insurance Co. v. Struble*, 82 Ohio App. 480, 485, 81 N.E.2d 622, 625, *appeal dismissed*, 150 Ohio St. 409, 82 N.E.2d 856 (1948). See also O.R.C. § 1701.59(C), which states that "a person who, as a director of a corporation, performs his duties in accordance with division (B) of this section (discussed above) shall have no liability because he is or has been a director of the corporation." The business judgment rule recognizes that many important corporate decisions are made under conditions of uncertainty, and it prevents courts from imposing liability on the basis of ex post judicial hindsight and lowers the volume of costly litigation challenging directorial actions. *See generally* 3A W. Fletcher, *Cyclopedia of the Law of Private Corporations § 1039, at 37-38 (1975 ed.)*.

Plaintiffs contend, however, that the trial court's instructions were erroneous because they failed to state the proposition established by *Ohio Drill & Tool Co. v. Johnson*, 625 F.2d 738, 742 (6th Cir. 1980), and *Seagrave v. Mount*, 212 F.2d 389, 397 (6th Cir. 1954), that good faith and full disclosure to shareholders do not insulate a director from liability if he has placed himself in a position of conflicting loyalties to the corporation and his own private interest. We find no conflict

between these cases and the substance of the trial court's instructions. Both *Ohio Drill & Tool* and *Seagrave v. Mount* simply apply the rule that directors owe a duty of loyalty to the corporation and are not entitled to the discretion permitted by the business judgment rule when they are interested in a corporate control transaction which is the subject of their business judgment as directors. The trial court's instructions may not possess the clarity of a restatement, but in explicitly telling the jury that a fiduciary "must give his undivided loyalty" to the corporation and breaches his duty if he intentionally acts contrary to the best interests of the corporation, the court accurately stated the law in a manner consistent with *Ohio Drill & Tool* and *Seagrave v. Mount*.

In light of recent Supreme Court decisions severely restricting the substantive content of the federal securities laws as applied to tender offers and takeovers, and emphasizing the traditional role of state law in regulating the fairness of corporate control transactions, *see, e.g., Schreiber v. Burlington Northern*, ____ U.S. ____, 105 S.Ct. 2458, 86 L.Ed.2d 1 (1985); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977), we have no wish to narrow the scope of state law fiduciary duties. Tender offers almost always present a potential conflict of interest for managers. But we cannot accept plaintiffs' underlying contention that in the context of corporate control transactions the burden of proof shifts to the directors to establish the fairness to shareholders of any transaction that would have the effect of retaining the directors' control. We reject the view that the stock option agreement and employment assurance alone placed the directors in a position of conflicting loyalties so that the burden of proof shifted to the defendants. Although there are no reported Ohio decisions addressing this contention, it has been rejected overwhelmingly in recent decisions from other jurisdictions involving an attack on the actions of corporate directors allegedly taken for the purpose of preserving corporate control in the face of a hostile tender offer, *Panter v. Marshall Field & Co.*, 646 F.2d 271, 295 (7th Cir.), *cert. denied*, 454 U.S. 1092, 102 S.Ct. 658, 70 L.Ed.2d 631 (1981);

Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 701-03 (2d Cir. 1980); *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 381 (2d Cir. 1980), and the general rule remains that directors carry the burden of showing that a transaction is fair and in the best interests of shareholders only *after* the plaintiff has made a prima facie case showing that the directors have acted in bad faith or without requisite objectivity. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir. 1984); ALI, Principles of Corporate Governance: Analysis and Recommendations, § 4.01 at 6, 11 (Tent. Draft No. 4, April 12, 1985) (protections of business judgment rule removed only if a challenging party can sustain his burden of showing the director was not acting in good faith or with disinterest, or was not informed as to the subject of his business judgment).

It may be that some corporate control events, such as the payment of greenmail, should shift the burden of proof and invoke close judicial scrutiny, *see* Note, *Greenmail: Targeted Stock Repurchase and the Management-Entrenchment Hypothesis*, 98 Harv.L.Rev. 1045, 1056-59 (1985), but here the transaction merely provided that long term stock options—held by upper level management only and not by the outside directors—would be cashed out at the anticipated average price in the two-tier transaction, and that the officer-directors would be continued in their present positions, although their employment remained terminable at will. There were no severance payments or "golden parachutes" involved, and unlike *Norlin*, where the board of directors effectively assured itself voting control over the company in order to ward off hostile stock purchases by issuing new common and preferred to its wholly owned Panamanian subsidiary and to a newly created employee stock ownership plan, the ultimate decision on the proposed transaction with Steel was made by the shareholders in deciding to tender their shares and vote for the merger, thus preserving the fundamental principle of corporate governance that shareholders must control decisions affecting the corporation's survival as a legal entity.

B. Marathon's Liability for Breach of Fiduciary Duty

The plaintiffs maintain that the District Court erred in

instructing the jury that Marathon had no fiduciary duty to its shareholders and that plaintiffs' claim for breach of fiduciary duty was limited to its claim against Marathon's directors. Plaintiffs say that Marathon itself owed a fiduciary duty to its shareholders because the fiduciary duty of an officer or director derives from his position as a representative of the corporation, or alternatively, that the fiduciary duty of an officer or director creates a fiduciary duty in the corporation.

Plaintiffs' argument is based on a fundamental misunderstanding of the nature of the corporate director's fiduciary relationship. A corporation is a legal entity created in derogation of the common law and the obligations of the corporation are defined by statute, as are the rights of shareholders. Under O.R.C. §§ 1701.59(A) and (B), except where the law, articles of incorporation or corporate regulations require action to be authorized by shareholders, all of the authority of a corporation is to be exercised under the direction of the corporation's directors, who must act in a manner they reasonably believe to be in the corporation's best interests. The directors stand, roughly, as trustees over the corporation, administering it for the benefit of the beneficial owners, the shareholders. *See* 3 W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 848 (1975 ed.). Liability for breach of the directors' fiduciary obligation could not possibly run against the corporation itself, for this would create the absurdity of satisfying the shareholders' claims against the directors from the corporation, which is owned by the shareholders. There is not, and could not conceptually be any authority that a corporation as an entity has a fiduciary duty to its shareholders. *See Jordan v. Global Natural Resources, Inc.*, 564 F.Supp. 59, 68 (S.D.Ohio 1983).[9]

Similarly, although a corporation may be held vicariously liable to third parties for acts of directors and officers within

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9. The cases plaintiffs cite for the proposition that a corporation may have a fiduciary duty to shareholders all involve situations where the corporation owed a fiduciary duty to minority shareholders of a second corporation of which it was majority shareholder. *See, e.g., Southern Pacific Co. v. Bogert*, 250 U.S. 483, 491-92, 39 S.Ct. 533, 536-37, 63 L.Ed. 1099 (1919); *Zahn v. Transamerica Corp.*, 162 F.2d 36, 42 (3d Cir. 1947).

their authority as representatives of the corporation, *see, e.g., Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011, 101 S.Ct. 566, 66 L. Ed.2d 469 (1980), such vicarious liability has been sparingly imposed, primarily on brokerage firms in dealings with customers because of the special duty owed by brokers to customers. *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 182 (3d Cir. 1981). Plaintiffs have cited no case in which a corporation has been held vicariously liable to its shareholders for its directors' breach of fiduciary duty, and such a result would be flatly inconsistent with the rationale of vicarious liability, since it would shift the cost of the directors' breach from the directors to the corporation and hence to the shareholders, the class harmed by the breach.

C. Joint and Several Liability of the Marathon Defendants, and Other State Law Claims

The plaintiffs assert that the jury verdict form on breach of fiduciary duty was erroneous because it did not permit the jury to find that some Marathon directors were liable while others were not and essentially instructed the jury that only joint and several liability could be found. Plaintiffs say this verdict form was particularly prejudicial because some of the directors, the officer-directors in particular, had greater knowlege and conflicts of interest than did others, and because of the inclusion of a prominent national hero, astronaut Neil Armstrong, an outside director, along with the other directors.

The Marathon board unanimously approved the merger with Steel, and unanimously agreed to oppose Mobil's offer, and the evidence was uncontroverted that these decisions were taken by the board as a whole. (*See* Hoopman testimony at T. 832-37, A. 358-63.) The law is clear that directors and officers of a corporation are jointly and severally liable if they jointly participate in a breach of fiduciary duty or approve, acquiesce in, or conceal a breach by a fellow officer or director. *Ohio Drill & Tool Co. v. Johnson*, 625 F.2d at 742; *Nienaber v. Katz*, 69 Ohio App. 153, 43 N.E.2d 322 (1942); 3 W. Fletcher,

Cyclopedia of the Law of Private Corporations § 1002, at 546-47 (1975 ed.). Moreover, there is no authority in Ohio for the proposition that outside directors must be treated differently with respect to joint decisions by the entire board.

Plaintiffs also contend that Steel could have been found jointly liable at the tender offer stage for knowingly joining in a breach of fiduciary duty by Marathon's directors, but there is no authority for this exceptionally problematic notion, and the contention is in any event moot given that the jury, on the basis of correct instructions, found unanimously that Marathon's directors had not breached their fiduciary duty. Plaintiffs' attack on the trial court's failure to allow emendation of the complaint to include a claim that statements regarding the nature of the Strong and First Boston reports in the proxy materials were false and misleading is equally without merit. Similarly without merit is the plaintiffs' contention that the court's decision to admit the testimony of class member Fishbein was reversible error, and we find all other miscellaneous points of error raised by the plaintiffs to be groundless.

Accordingly, the judgment of the District Court is affirmed.

Appendix B

No. 84-3215.

UNITED STATES COURT OF APPEALS, SIXTH CIRCUIT.

Argued Jan. 22, 1985.

Decided Sept. 13, 1985.

Irving STARKMAN, M.D., Trustee of the Irving Starkman, M.D., S.C. Defined Benefit Pension Fund and Trust, on behalf of himself and all others similarly situated, Plaintiff-Appellant,

v.

MARATHON OIL COMPANY, an Ohio corporation, H.D. Hoopman, C.H. Barre, V.G. Beghini, H.H. Hering, and W.E. Swales, Defendants-Appellees.

Lawrence Walner, Lawrence Walner & Associates, Chicago, Ill., Larry A. Temin, Strauss, Troy & Ruehlmann Co., Cincinnati, Ohio, Edward Slovick, argued, James Gordon, Chicago, Ill., for plaintiff-appellant.

Murray S. Monroe, Cincinnati, Ohio, John M. Newman, John W. Edwards, III, Robert R. Weller, John L. Strauch, argued, Cleveland, Ohio, James T. Griffin, Michael P. Mullen, William J. Raleigh, Chicago, Ill., for defendants-appellees.

Before MERRITT and KENNEDY, Circuit Judges, and PECK, Senior Circuit Judge.

MERRITT, Circuit Judge.

Like *Radol v. Thomas*, 772 F.2d 244 (6th Cir. 1985), this action arises out of U.S. Steel's November, 1981 acquisition and eventual merger with Marathon Oil Company. The plaintiff here, Irving Starkman, was a Marathon shareholder until selling his shares on the open market for $78 per share on November 18, 1981, the day before U.S. Steel's tender offer

for 51% of Marathon's outstanding shares at $125 per share was announced.[1] On October 31, 1981, Mobil Oil had initiated its takeover bid for Marathon, a bid which Marathon actively resisted by urging its rejection by Marathon shareholders and by seeking and eventually finding a "white knight" or alternative, friendly merger partner-tender offeror, U.S. Steel. Starkman claims that Marathon's board violated Rule 10b-5 and its fiduciary duty to him as a Marathon shareholder by failing to disclose various items of "soft" information—information of less certainty than hard facts—in its public statements to shareholders during the period after Mobil's hostile tender offer and prior to Steel's friendly tender offer. In particular, he says that Marathon should have told shareholders that negotiations were underway with U.S. Steel prior to the consummation of those negotiations in an agreement, and that internal and externally-prepared asset appraisals and five-year earnings and cash flow projections should have been disclosed to shareholders so that they could make a fully informed choice whether to sell their shares or gamble on receiving a higher price in a possible Steel-Marathon merger.

The District Court granted summary judgment for Marathon, finding that these items of soft information had either been sufficiently disclosed or were not required to be disclosed because their nondisclosure did not render materially misleading Marathon's other affirmative public statements. For the reasons stated below, we affirm the judgment of the district Court.

I. BACKGROUND

We have discussed the background and structure of U.S. Steel's acquisition of Marathon Oil at some length in *Radol v. Thomas*, 772 F.2d 244 (6th Cir. 1985), and our attention here

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1. Although Starkman still styles his case as a class action, the District Court twice denied motions for class determination, and this issue is not before us on appeal.

will therefore be focused on the facts which are especially relevant to Starkman's Rule 10-5 claims.[2]

In the summer of 1981, Marathon was among a number of oil companies considered to be prime takeover targets. In this atmosphere, Marathon's top level management began preparations against a hostile takeover bid. Harold Hoopman, Marathon's president and chief executive officer, instructed the company's vice presidents to compile a catalog of assets. This document, referred to as the "Strong Report" or "internal asset evaluation," estimated the value of Marathon's transportation, refining and marketing assets, its other equipment and structures, and the value of proven, probable, and potential oil reserves as well as exploratory acreage. Hoopman and John Strong, who was responsible for combining materials received from various divisions into the final report, both testified that the Strong report was viewed as a "selling document" which placed optimistic values on Marathon's oil and gas reserves so as to attract the interest of prospective buyers and ensure that Marathon could either ward off an attempt to capture Marathon at a bargain price or obtain the best offer available.

In estimating proven, probable, and potential reserves and exploratory acreage, the Strong Report was based on information that was not available to the general public, for example in annual reports, because only the value of proven reserves was normally included in such public documents. The Strong Report defined proven reserves as those actually producing, probable reserves as reserves for properties where some production had been established and additional produc-

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2. Judge Rubin disposed of this suit on summary judgment after the trial in *Radol v. Thomas*. Although very limited discovery was allowed prior to the summary judgment order, Starkman moved to supplement the record on this appeal, with a large amount of evidence taken in *Radol v. Thomas*, including the Strong and First Boston reports, Doc. 91, and this motion was unopposed by Marathon and was granted. Doc. 98. All the facts discussed in this section are properly in the record in this appeal as supplemented, but references to their physical location in the *Radol v. Thomas* appellate record will be explicitly noted where appropriate. Otherwise, "A" denotes the appendix in this appeal.

tion was likely, and potential reserves as reserves for properties where production had not yet been established but where geologic evidence supported wildcat drilling.[3] These reserves were valued using a discounted cash flow methodology, under which the present value of oil reserves is calculated by summing risk discounted expected net revenues from the particular field over the life of the field, and then discounted into present value by dividing by an estimated interest rate. This valuation method, a standard procedure for determining the cash value of oil and gas properties, required projections of price and cost conditions prevailing as far as 20 years into the future. For example, the Strong Report assumed that the rate of increase in oil prices would average over 9% per year from 1980-1990.

Using this methodology, the Strong Report valued Marathon's net assets at between $19 billion and $16 billion (depending on which set of interest rates was used to discount back to present value), a per share value of between $323 and $276. The value of oil and gas reserves made up $14 billion of the $19 billion estimate and $11.5 billion of the $16 billion estimate. A similar report using identical methodology was prepared in mid-July 1981 by the investment banking firm of First Boston, which had been hired by Marathon to assist in preparing for potential takeover bids. The First Boston Report was based only upon proven and probable oil reserves and was also intended to be used as a "presentation piece" to avoid a takeover or maximize the price obtained in a takeover. It placed Marathon's value at between $188 and $225 per share.

Some perspective on the values arrived at in the Strong and First Boston reports can be gained from other, publicly available appraisals of Marathon's assets prepared during 1981. The Herold Oil Industry Comparative Appraisal placed Marathon's appraised value at $199 per share, and two other reports by securities analysts said Marathon had an appraised value of between $200 and $210 per share.[4]

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3. These definitions appear at pages 1160-1162 in the Appendix in *Radol v. Thomas*.

4. *See Radol v. Thomas* appendix at 2585, 2590.

Marathon's market value, however, was well below these appraised values. On October 29, 1981, Marathon closed at $63.75 per share. The next day, Mobil Oil announced its tender offer to purchase up to approximately 68% of outstanding Marathon common stock for $85 per share in cash. Mobil proposed to follow the tender offer with a going private or freezeout merger in which the remaining shareholders of Marathon would receive sinking fund debentures worth approximately $85 per share.

On October 31, 1981, Marathon's board of directors met in emergency session and unanimously decided that the Mobil offer was "grossly inadequate" and approved a vigorous campaign to persuade Marathon shareholders not to tender to Mobil, and to simultaneously seek a "white knight." On November 11 and 12, Marathon's Board made public statements to the shareholders recommending rejection of Mobil's bid as "grossly inadequate" and against the best interests of the company. We explore these statements in more detail below, as they are a primary focus of Starkman's claims of inadequate disclosure. However, at the time these statements to shareholders were made, Marathon representatives had already contacted all of the 30 to 35 companies who could possibly undertake an acquisition topping Mobil's bid, and, in particular, had begun negotiations with U.S. Steel on November 10. The Strong and First Boston reports were given to Steel on that same day, on the condition that they be kept confidential, and on November 12, Marathon's vice president for finance delivered five-year earnings forecasts and cash flow projections to Steel in Pittsburgh.

On November 17, Hoopman and David Roderick, Steel's president, reached agreement on the terms of Steel's purchase of Marathon, and, after Board approval, an agreement was signed on November 18, 1981. Under the terms of the agreement, Steel would make a tender offer for up to 31 million shares (about 51%) of Marathon stock for $125 per share in cash, to be followed by a merger proposal in which each remaining Marathon shareholder would receive one $100 face value, 12 year, 12½ per cent guaranteed note per share of

common stock. On November 19, Steel mailed its tender offer to Marathon shareholders, and Hoopman sent a letter to Marathon shareholders describing the two-stage deal and stating the opinion of Marathon's Board that the agreement was fair to Marathon shareholders. Steel's offer was successful, with over 91% of the outstanding shares tendered, and the second stage freezeout merger was approved by a two-thirds majority of the remaining shareholders in February, 1982.

II. MARATHON'S PUBLIC STATEMENTS AND DISPOSITION BELOW

There are three public statements by Marathon management at issue here. First, Marathon's November 11, 1981, press release, which states, in pertinent part, that:

> Our Board of Directors has determined that Mobil Corporation's unsolicited tender offer is grossly inadequate. The offer is not in the best interests of Marathon Oil or its shareholders. It doesn't reflect current asset values and it doesn't permit the long-term investor the opportunity to participate in the potential values that have been developed.
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> * * *
>
> We plan to do everything we possibly can to defeat this offer. We are determined to stay independent.

A. 187.

The next day, as required by Rule 14e-2, 17 C.F.R. § 240.14e-2 (1984), Marathon mailed a letter to its shareholders stating its position regarding Mobil's tender offer. The letter urged rejection of the offer, stating that Marathon's Board was "convinced that the Mobil offer is grossly inadequate and does not represent the real values of the assets underlying your investment in Marathon." A. 182. The letter described a number of alternative courses of action that were being considered by the Board, including "repurchase of Marathon shares, acquisition of all or part of another company, a business combination with another company, (and) the decla-

ration of an extra ordinary dividend and a complete or partial liquidation of the Company," *id.*, and concluded by again urging rejection of Mobil's attempt to "seize control of Marathon's assets at a fraction of their value," and stating that "[w]e are convinced that you and our other shareholders would be well served if Marathon remains independent." *Id.*

Attached to this letter was a copy of Marathon's Schedule 14D-9, filed pursuant to Rule 14d-9, 17 C.F.R. § 240.14d-9, in which the board informed the SEC that it had recommended rejection of the Mobil offer as "grossly inadequate." Item 4(b)(iv) of Marathon's Schedule 14D-9 listed as a factor supporting this recommendation the board's belief that based on current economic and market factors, "this is an extremely inopportune time to sell the Company and, in any event, that its shareholders would be better served if the Company were to remain independent." A. 92. Item 7 of this same schedule described "Certain Negotiations and Transactions" by Marathon:

> At a meeting of the Board of Directors held on October 31, 1981, the Board considered and reviewed the feasibility and desirability of exploring and investigating certain types of possible transactions, including, without limitation, repurchases of Company Common Shares, the public or private sale of equity or other securities of the Company, a business combination between the Company and another company, the acquisition of a significant interest in or the entire Company or of one or more of its significant business segments by another company, a joint venture between the Company and one or more other companies, the acquisition by the Company of all or part of the business of another Company, a complete or partial liquidation of the Company or the declaration of an extraordinary dividend. After considerable discussion, the Board resolved that it was desirable and in the best interest of the Company and its shareholders to explore and investigate, with the assistance and advice of First Boston, such transactions, although the Board noted that

> the initiation or continuation of such activities may be dependent upon Mobil's future actions with respect to the Mobil Offer. There can be no assurance that these activities will result in any transaction being recommended to the Board of Directors or that any transaction which is recommended will be authorized or consummated.

A. 96

Starkman argues that the failure of any of these communications to disclose the Strong and First Boston reports and the five-year earnings and cash flow projections constituted an omission of material facts which rendered these communications materially misleading, and that Marathon not only failed to adequately disclose its search for a white knight and its negotiations with Steel but actually gave the false impression that the Board was endeavoring to preserve Marathon as an independent entity. He argues that the Strong and First Boston reports, the five-year cash and earnings projections, and the fact of ongoing negotiations with U.S. Steel were all material facts because knowledge of them would have affected a reasonable shareholder's evaluation of the likelihood that Marathon would succeed in negotiating a higher price takeover, and thereby affect such a shareholder's decision to sell his shares. He contends that shareholders were not adequately informed of Marathon management's search for a "white knight" and of the negotiations with Steel, and that failure to disclose more information regarding these negotiations rendered statements suggesting that Marathon might remain independent materially misleading. Similarly, Starkman contends that if he had been told of the Strong and First Boston reports and the five-year earnings and cash flow projections, and also that Marathon management was using these figures in seeking an alternative bidder, then he would have anticipated a much higher bid than he did, and that failure to release this information rendered materially misleading the affirmative statements Marathon did make.

In his brief on this appeal, Starkman has repeatedly mischaracterized the decision of the District Court as holding

that none of the information Starkman contends should have been disclosed was material. To understand the District Court's holding in this case, it is important to note at the outset that in *Radol v. Thomas*, 772 F.2d 244 No. 83-3598 (6th Cir. 1985), the plaintiffs claimed that the same asset appraisals at issue here should have been disclosed by Steel in its tender offer and by Marathon in its statements recommending that shareholders accept Steel's offer. Judge Rubin presided over both the present suit and *Radol*, and in *Radol* he denied the defendant's motion for summary judgment on the issue of whether the asset appraisals should have been disclosed at the time of Steel's tender offer on the ground that the reports were not, as a matter of law, immaterial, and he sent the materiality of these reports to the jury. *See Radol v. Thomas*, 566 F.Supp. 586, 594 (S.D.Ohio 1983).

In granting summary judgment for Marathon in the present action, however, Judge Rubin found that the net asset values stated in the Strong and First Boston reports were perfectly consistent with Marathon's repeated public assertion that Mobil's bid was "grossly inadequate" in light of the true value of Marathon's assets, and that disclosure of the reports was not required under Rule 10b-5 because "disclosure of information which is consistent with other statements made is obviously not necessary in order to make those statements not misleading. Such disclosure would simply reinforce, rather than correct or modify, the statements made." A. 16. As to the claim that nondisclosure of the reports rendered misleading Marathon's statements that the best result would be for the company to remain independent, the District Court said that these statements were not misleading when placed in the context of the repeated assertion that Mobil's offer was "grossly inadequate" and that alternatives including merger into another company were under consideration. A. 17.

The District Court summarily disposed of the claim that the five-year earnings and cash flow projections should have been disclosed, concluding that disclosure of such information is simply not required under *Marsh v. Armada Corp.*, 533 F.2d 978, 986-87 (6th Cir. 1976), *cert. denied*, 430 U.S. 954,

97 S.Ct. 1598, 51 L.Ed.2d 803 (1977), and *Arber v. Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir. 1974), *cert. denied*, 419 U.S. 830, 95 S.Ct. 53, 42 L.Ed.2d 56 (1974). A. 18.

As to disclosure of the negotiations with Steel, the District Court cited *Reiss v. Pan American World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983), and *Staffin v. Greenberg*, 672 F.2d 1196, 1206 (3d Cir. 1982), in ruling that Marathon's 14D-9 disclosure that the acquisition of all or part of another company, or merger with another company, was being considered as an alternative to the Mobil offer sufficed to meet whatever disclosure obligation may have existed. A. 19-20.

III. DISCUSSION

A. Introduction

Pursuant to Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.§ 78j(b) (1982), which prohibits the use of any "manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe," "in connection with the purchase or sale of any security," the SEC promulgated Rule 10b-5, which provides in pertinent part that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> * * *
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . .

17 C.F.R. § 24.1b-5 (1984).

Aptly described as a "judicial oak which has grown from little more than a legislative acorn," *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737, 95 S.Ct. 1917, 1926, 44 L.Ed.2d 539 (1975), Rule 10b-5 has been the source of a

wide-ranging federal common law of securities fraud, clearly applicable to the tender offer context, provided that, as here, there has been a purchase or sale of a security. *See* 3 L. Loss, *Securities Regulation* 1445 (2d ed. 1961).

Despite occasional suggestions by commentators, *see, e.g.*, Bauman, *Rule 10b-5 and the Corporation's Affirmative Duty to Disclose*, 67 Geo.L.J. 935 (1979), and the courts, *Zweig v. Hearst Corp.*, 594 F.2d 1261, 1266 (9th Cir. 1979), that Rule 10b-5 imposes an affirmative obligation on the corporation to disclose all material information regardless of whether the corporation has made any other statements, the established view is that a "duty to speak" must exist before the disclosure of material facts is required under Rule 10b-5. *See Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978, 984 (3d Cir. 1984) (citing *Chiarella v. United States*, 445 U.S. 222, 235, 100 S.Ct. 1108, 1118, 63 L.Ed.2d 348 (1980); *Staffin v. Greenberg*, 672 F.2d 1196, 1202 (3d Cir. 1982)). Provided that such a duty to speak exists, a further limitation on the duty to disclose is imposed by the requirement that only misstatements of material facts and omissions of material facts necessary to make other required statements not misleading are prohibited by Rule 10b-5. The Supreme Court's definition of "material" in the context of an alleged violation of Rule 14a-9, governing disclosure requirements in proxy statements, has been adopted for cases involving Rule 10b-5 in the tender offer context. *Flynn v. Bass Brothers Enterprises*, 744 F.2d at 985; *Staffin v. Greenberg*, 672 F.2d at 1205; *Panter v. Marshall Field & Co.*, 646 F.2d 271, 282 (7th Cir.), *cert. denied*, 454 U.S. 1092, 102 S.Ct. 658, 70 L.Ed.2d 631 (1981). That definition reads as follows:

> An omitted fact is material if there is substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. This standard is fully consistent with [*Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970)] general description of materiality as a requirement that "the defect have a significant propensity to affect the voting process."

> It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976).

In structuring the disclosure duties of a tender offer target, we begin therefore with the basic proposition that only material facts—those substantially likely to affect the deliberations of the reasonable shareholder—must be disclosed, and then *only* if the nondisclosure of the particular material facts would make misleading the affirmative statements otherwise required by the federal securities laws and SEC regulations.

Our adherence to this basic proposition ensures that target management's disclosure obligations will strike the correct balance between the competing costs and benefits of disclosure. The benefits of disclosure in ensuring that shareholders who are suddenly faced with a tender offer will not be forced to respond without adequate information are clearly recognized in Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e), which somewhat broadens the reach of Rule 10b-5 to statements made "in connection with any tender offer" and which provides the statutory authority for SEC rules imposing affirmative disclosure obligations on tender offer targets.[5]

5. Section 14(e) provides, in part, that:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer. . . .

On the other hand, tender offers remain essentially contests in which participants on both sides act under the "stresses of the marketplace," and "[p]robably there will no more be a perfect tender offer than a perfect trial." *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 948 (2d Cir. 1969) (Friendly, J.). Under these conditions, imposing an "unrealistic requirement of laboratory conditions," *id.*, would place target management under the highly unpredictable threat of huge liability for the failure to disclose, perhaps inducing the disclosure of mountains of documents and hourly reports on negotiations with potential tender offerors, a deluge of information which would be more likely to confuse than guide the reasonable lay shareholder and which could interfere with the negotiation of a higher tender offer and actually reduce the likelihood that a shareholder will benefit from a successful tender offer at a premium over the market. It is with these competing considerations in mind that we turn to the particular disclosure claims made here.

B. Assets Appraisals and Earnings Projections

We first address Starkman's contention that Marathon should have disclosed the Strong and First Boston reports and the five-year earnings projections and forecasts given to Steel. Under the authority of Section 14(e) of the Williams Act, the SEC requires a tender offer target to make two affirmative statements regarding an offer. First, Rule 14e-2 requires that the target company mail or publish a statement to its shareholders within 10 days of the tender offer stating its position (or stating it cannot take a position) and giving reasons for the position. Under Rule 14d-9, a Schedule 14D-9 must be filed with the SEC "as soon as practicable" after the recommendation letter is sent to shareholders. The information to be included in the Schedule 14D-9 is described in 17 C.F.R. § 14d-101. Significantly, although Item 4 of the Schedule 14D-9 is to contain a statement of the reasons for the target's position with respect to the offer, and Item 8 requires disclosure of any additional information as "may be necessary to make the required statements, in light of the circumstances

under which they are made, not misleading" neither the shareholder recommendation letter nor the Schedule 14D-9 must contain internal asset appraisals, appraisals done by outside consultants such as First Boston, or earnings and cash flow projections.

Since there is no SEC rule specifically requiring the disclosure of this information, we must determine whether Rule 10b-5 requires its disclosure as material information, the nondisclosure of which would render misleading other statements made by Marathon. The starting point in this analysis is the underlying regulatory policy toward disclosure of such information, since regulatory rules reflect careful study of general conditions prevailing in the securities marketplace and provide guidelines upon which corporate officers and directors are entitled to rely.

The SEC's policy toward the inclusion of appraised asset valuations, projections and other "soft" information in proxy materials, tender offers and other disclosure documents has undergone a gradual evolution toward *allowing* the inclusion of such information in some special contexts, provided that the assumptions and hypotheses underlying predicted values are also disclosed.

In 1976 future earnings projections were deleted from a list of examples of potentially misleading disclosures in proxy statements in the note which followed Rule 14a-9. *See* Securities Act Release No. 5699, *reprinted in* [1975-76 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 80, 461 (1976). And, effective July 30, 1979, the SEC adopted a "safe harbor" rule for projections, under which a statement containing a projection of revenues and earnings would not be considered to be a materially misleading misstatement or omission for purposes of liability under the federal securities laws provided the statement was prepared with a reasonable basis and was disclosed in good faith. *See* Securities Act Release No. 6084 *reprinted in* [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 82,117, at 81,939 (June 25, 1979).

With respect to asset appraisals, Rule 13e-3, 17 C.F.R. § 240.13e-3, requires disclosure of the information called

for by Items 7, 8, and 9 of Schedule 13E-3, 17 C.F.R. § 240.13e-100, in the context of freezeout mergers. Item 8 of Schedule 13E-3 requires disclosure of factors important in determining the fairness of such a transaction to unaffiliated shareholders, and these factors include liquidation value; Item 9 of that same schedule says that a summary of any outside appraisal must be furnished, with the summary including a discussion of the procedures and methods of arriving at the findings and recommendations of the appraisal. However, a 1979 SEC-proposed amendment under which an issuer would have to disclose any projection given to an appraisal furnisher was never adopted, *see* 2 Fed.Sec.L.Rep. (CCH) ¶23-706, at 17,245-21 through 21A, and, even more importantly, in *Radol v. Thomas*, 772 F.2d 244 No. 83-3598, (6th Cir. 1985), we have rejected the position that SEC rules regarding freezeout mergers and proxies should determine the disclosure obligations of target management in the first stage of a two-tier tender offer.[6]

Finally, we note that until March, 1982, Regulation S-K, the source for disclosure obligations in annual reports, registration documents and other documents that must be filed with the SEC, provided in Instruction 2 to Item 2(b) that estimates of probable or possible oil and gas reserves should not be disclosed in any document publicly filed with the SEC. *See* Securities Act Release No. 6008, *reprinted in* [1978 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 81, 768, at 81,104 (Dec. 19, 1978). The underlying reason was that "estimates of prob-

6. In addition, while the note to Rule 14a-9 lists "predictions as to specific future market values" as a potentially misleading proxy statement disclosure, the SEC in 1980 authorized disclosure of good faith appraisals made on a reasonable basis in proxy contests in which a principal issue is the disposition of the issuer's assets, provided that the valuations are accompanied by "disclosure which facilitates shareholders' understanding of the basis for and limitations on the projected realizable values." Exchange Act Release No. 34-16833, *reprinted in* 3 Fed.Sec.L.Rep. (CCH) ¶ 24,117 (May 23, 1980). This same release cautioned, however, that where "valuations are so qualified and subject to material limitations and contingencies, inclusion in proxy soliciting material of specific realizable values may be unreasonable." 3 Fed.Sec.L.Rep. (CCH) at 17, 621-13.

able or possible reserves and any value thereof are not sufficiently reliable to be included . . . and may be misleading to investors." *Id.* In March, 1982, well after Steel's tender offer, Item 102 of Regulation S-K was amended to *allow* disclosure of "estimated" as well as proved reserves where such estimates have previously been provided to a person who is offering to acquire or merge with the subject company, *see* Securities Act Release No. 6383, *reprinted in* [1937-1982 Accounting Series Release Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 72,328, at 63,003 (March 3, 1982). The Strong and First Boston reports contain estimates of probable and possible reserves, and the disclosure of this information was actually prohibited at the time of Steel's tender offer, and only *permitted* since that time.

Thus, at the time of Steel's tender offer, the SEC did not require disclosure of earnings projections in any context, and required disclosure of asset appraisals, in summary form, only in the special context of freeze-out mergers, which differs markedly from the setting of a first-stage tender offer. Although the SEC allowed disclosure of projections, provided they were prepared on a "reasonable basis" and in "good faith," and also allowed disclosure of similarly supported asset appraisals in some proxy contests, it forbade the disclosure of estimates of probable and potential oil and gas reserves, a major component of the Strong and First Boston appraisals. Absent compelling authority to the contrary, we are reluctant to impose liability on Marathon for failing to disclose asset appraisals based on hypothetical valuations which the SEC did not then permit to be disclosed in most contexts, particularly since Section 23(a) of the Securities and Exchange Act, 15 U.S.C. § 78w(a)(1) provides that no liability under the federal securities laws shall be imposed for "any act done or omitted in good faith conformity with a rule, regulation, or order of the Commission." *See Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1292-94 (2d Cir. 1973) (refusing, per Friendly, J., to impose liability on the basis of an ex-post modification in SEC policy for non-disclosure in 1963 merger proxy statement of asset appraisals when it was an "article of faith"

among securities lawyers in 1963 that such appraisals could not be included in a proxy statement.).

Rather than suggesting a duty to disclose the Strong and First Boston reports, however, our cases firmly establish the rule that soft information such as asset appraisals and projections must be disclosed only if the reported values are virtually as certain as hard facts.

This Court has recently held that a target's failure to disclose an appraisal based on five-year cash flow and earnings projections and intended to be used as a selling document in ongoing merger discussions did not violate Rule 10b-5. *Biechele v. Cedar Point, Inc.*, 747 F.2d 209 (6th Cir. 1984). Chief Judge Lively's opinion for the court reasoned that the report was a "selling document" which "contained projections and speculative assumptions which were little more than predictions of future business success," and valuations based on the replacement cost of assets which could be misleading to shareholders, since they varied from balance sheet information prepared according to accepted accounting principles. *Id.* at 216. Similarly, in *James v. Gerber Products Co.*, 587 F.2d 324, 327 (6th Cir. 1978), we held that the failure to disclose interim earnings reports in connection with a shareholder's sale of stock back to the issuing company did not violate Rule 10b-5, because "such sales figures, projections, forecasts and the like only rise to the level of materiality when they can be calculated with substantial certainty." And in *Arber v. Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir.), *cert. denied*, 419 U.S. 830, 95 S.Ct. 53, 42 L.Ed.2d 56 (1974), another case involving a corporate stock repurchase, then Judge McCree said that while a fixed plan of future corporate activity might, under some circumstances, be viewed as a material fact, Section 10(b) and Rule 10b-5 did not require a corporate insider to disclose his educated guesses or predictions, and "[i]n short, the law mandates disclosure only of existing material facts. It does not require an insider to volunteer any economic forecast." *See also Marsh v. Armada Corp.*, 533 F.2d 978, 987 (6th Cir. 1976), *cert. denied*, 430 U.S. 954, 97 S.Ct. 1598, 51 L.Ed.2d 803 (1977) (failure to make a

projection of future earnings in freeze-out merger proxy statement not actionable under Rule 10b-5).

Our cases fully support a rule under which a tender offer target must disclose projections and asset appraisals based upon predictions regarding future economic and corporate events only if the predictions underlying the appraisal or projection are substantially certain to hold. An example is when the predictions in fact state a fixed plan of corporate activity. If a target chooses to disclose projections and appraisals which do not rise to this level of certainty, then it must also inform the shareholders as to the basis for and limitations on the projected realizable values.[7]

The Third Circuit has enunciated a different test, under which "courts should ascertain the duty to disclose asset valuations and other soft information on a case by case basis, by weighing the potential aid such information will give the shareholder against the potential harm, such as undue reliance, if the information is released with a proper cautionary note." *Flynn v. Bass Brothers Enterprises,* 744 F.2d at 988. The court listed several factors the courts have considered in determining the reliability of soft information, including the qualifications of those who prepare the appraisal, the degree of certainty of the data on which it was based, and the purpose for which it was prepared. 744 F.2d at 986, 988 (compiling cases); *see also Panter v. Marshall Field,* 646 F.2d at 292-93.

By its very nature, however, this sort of judicial cost-benefit analysis is uncertain and unpredictable, and it moreover neglects the role of the market in providing shareholders with information regarding the target's value through compet-

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7. We note that this rule is fully consistent with the recent statement by the SEC Advisory Committee on Tender Offers that "current disclosures of projections and valuations given to a bidder by a target company are essentially meaningless and can be misleading without disclosure of the underlying assumptions," and with that Committee's recommendation that "[w]here the bidder discloses projections or asset valuations to target company shareholders, it must include disclosure of the principal supporting assumptions provided to the bidder by the target." *See* SEC Advisory Committee on Tender Offers, Report of Recommendations, at 29 (July 8, 1983).

ing tender offers. Our approach, which focuses on the certainty of the data underlying the appraisal or projection, ensures that the target company's shareholders will receive all essentially factual information, while preserving the target's discretion to disclose more uncertain information without the threat of liability, provided appropriate qualifications and explanations are made.

Under this standard, Marathon plainly had no duty to disclose the Strong and First Boston reports, because these reports contained estimates of the value of probable, potential and unexplored oil and gas reserves which were based on highly speculative assumptions regarding the path of oil and gas prices, recovery rates and the like over a period of thirty to fifty years. Disclosure of such estimated values could well have been misleading without an accompanying mountain of data and explanations. There is no reported case actually holding that disclosure of appraised values of oil and gas reserves is required, and several which agree with our decision that such disclosure is not required.[8]

Similarly, Marathon had no duty to disclose the five-year earnings and cash flow projections given to Steel and First Boston. This information does not rise to the level of substantial certainty triggering a duty to disclose. *Biechele v. Cedar Point; James v. Gerber Products Corp.*, both *supra.*

Further, disclosure of the asset appraisals and earnings and cash flow projections was not required in order to ensure that other statements in Marathon's 14D-9 and in its letter recommending rejection of Mobil's bid were not misleading. Marathon stated that Mobil's $85 offer was "grossly inade-

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8. *See, e.g., Sunray v. DX Oil Co. v. Helmerich & Payne, Inc.*, 398 F.2d 447, 450-51 (10th Cir.1968) ("any statement concerning oil reserves other than in the category of 'proved' could certainly be misleading to any investor other than one who is an expert in the industry"); *Caspary v. Louisiana Land and Exploration Co.*, 579 F.Supp. 1105 (S.D.N.Y.1983), *aff'd*, 725 F.2d 189 (2d Cir.1984) (no duty to disclose internal projections regarding oil recovery rates and exploration costs); *Bradshaw v. Jenkins*, [1983-84 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 99,719 (W.D.Wash. March 9, 1984) (no duty to disclose consultant's estimated value of energy loan portfolio).

quate" and disclosure of highly uncertain information indicating that Marathon had a net asset value of over $200 per share would only have supported this statement, and could have actually misled shareholders into thinking that the market would actually support a price of $200 per share.

C.

Starkman's contention that Marathon should have disclosed more information regarding its search for a white knight and its negotiations with Steel are equally without merit. The SEC and the courts have enunciated a firm rule regarding a tender offer target's duty to disclose ongoing negotiations: so long as merger or acquisition discussions are preliminary, general disclosure of the fact that such alternatives are being considered will suffice to adequately inform shareholders; a duty to disclose the possible terms of any transaction and the parties thereto arises only after an agreement in principle, regarding such fundamental terms as price and structure, has been reached. *See* Item 7 of Schedule 14D-9, 17 C.F.R. § 240.14d-101 (1984); *Greenfield v. Heublein, Inc.*, 742 F.2d 751, 756-57 (3d Cir. 1984), *cert. denied*, ____ U.S. ____, 105 S.Ct. 1189, 84 L.Ed.2d 336 (1985) (rejecting an "intent to merge" trigger standard); *Staffin v. Greenberg*, 672 F.2d 1196, 1207 (3d Cir. 1982); *Reiss v. Pan American World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983).[9]

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9. *Greenfield v. Heublein* also held that Heublein's voluntary statement in response to a New York Stock Exchange inquiry that it knew of no reason for an unusual increase in trading activity in its stock when in fact it knew of ongoing merger negotiations was not false or misleading because the merger negotiations had not been formally disclosed and there was no indication that the information had been leaked or that insider trading had occurred. 742 F.2d at 759. This holding is directly contrary to the position taken by the SEC in that case as amicus that while a company may respond with "no comment" to stock exchange inquiries regarding unusual market activity, it may not state that no corporate development accounts for the stock activity when in fact it knows that merger negotiations are under way. This related position has not altered the Commission's longstanding policy that negotiations need not otherwise be disclosed unless an agreement in principle has been reached.

The rationale emerging from these cases is that when dealing with complex bargaining which may fail as well as succeed and which may succed on terms which vary greatly from those originally anticipated, the disclosure of preliminary discussions could very easily mislead shareholders as to the prospects of success, and by making public an impending offer, push the price of the target's stock toward the expected tender price, thereby depriving shareholders of the primary inducement to tender—a premium above market price—and forcing the offeror to abandon its plans or greatly increasing the cost of the offer. *See Staffin v. Greenberg*, 672 F.2d at 1207.

In the instant case, Marathon's shareholder recommendation letter and its Schedule 14D-9 stated that the company was considering a number of alternatives, including a merger with another firm. These statements adequately informed the shareholders of Marathon's plans. Additional statements in these documents to the effect that Marathon's board believed the best result would be for Marathon to remain independent were not misleading when read in their full context, and at most expressed a sincere hope which the board found unrealistic under the pressure of Mobil's offer.

Finally, Starkman's claims for fraud and breach of fiduciary duty are completely unsupported by authority in his brief, and were similarly neglected in his arguments below. We therefore affirm and adopt the reasoning of the District Court finding that no claim for fraud has been made out because Marathon did not fail to disclose any information necessary to make its other public statements not misleading, and that the directors' statements, made at a time of extraordinary pressure on the board, comported in all respects with federal law and did not breach a fiduciary duty to Marathon's shareholders.

Accordingly, the judgment of the District Court is affirmed.

Appendix C

No. C-1-82-13.

UNITED STATES DISTRICT COURT, S.D. OHIO, W.D.

Feb. 2, 1983

Irving and Charlotte RADOL, et al., Plaintiffs,

v.

W. Bruce THOMAS, et al., Defendants.

Jacob Stein, Cincinnati, Ohio, for plaintiffs.
John W. Beatty, Cincinnati, Ohio, for defendants.

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTION FOR PARTIAL SUMMARY JUDGMENT

CARL B. RUBIN, Chief Judge.

This case involves the takeover of Marathon Oil Company ("Marathon") by United States Steel ("Steel"). This matter is before the Court on two Motions for Partial Summary Judgment, one by those defendants connected with Marathon and one by those defendants connected with Steel. As the arguments contained in each are virtually identical, the two Motions will be addressed as one. The Motion seeks summary judgment on all of plaintiffs' claims under the federal securities laws.

Facts[1]

The facts will be briefly summarized here. Where necessary, they will be expanded in the Court's discussion *infra*.

On October 30, 1981, the Mobil Corporation announced an offer to purchase up to 40 million Marathon shares for $85.00 per share in cash. The Directors of Marathon deter-

1. *See also Radol v. Thomas*, 534 F.Supp. 1302, 1304-06 (S.D.Ohio 1982) (Findings of Fact on Motion for Preliminary Injunction).

mined to resist the tender offer. In connection with this effort, they retained First Boston Corporation ("First Boston") to investigate specific alternatives to the Mobil offer, including the location of potential "white knights."[2]

As early as June of 1981, the management of Marathon made plans to resist a hostile takeover. An internal document variously referred to as the "Strong Report" and the "internal asset valuation" was prepared as an inventory of corporate assets with an estimation of their value. At approximately the same time, First Boston was directed to prepare a valuation of Marathon assets based solely upon information available to the public. The Board of Directors was advised of the conclusions reached in both the internal asset valuation and the First Boston appraisal at a board meeting held on October 31, 1981. During its negotiations with Marathon prior to the actual tender offer, United States Steel was also provided with copies of these reports.

The reports contained value estimates of Marathon's proven, probable and possible oil reserves. The values in the two reports varied by billions of dollars. The First Boston Report gave an "asset valuation" of $189 to $226 per share; the Strong Report valued Marathon's assets at $276 to $323 per share. The calculations used in arriving at the values involved factors such as original cost, carrying cost, replacement cost and discount cash flow. The calculations were based on speculation and assumptions which included economic predictions as far as 50 years into the future and projections of the future price of oil. Although the reports were prepared by experts, the methods used in calculating these values were necessarily imprecise.

The reports were not prepared in the ordinary course of business. Instead, they were intended to be "selling documents" for use in attracting more favorable tender offers.

The Board of Directors considered the Mobil offer to be "grossly inadequate" and made a diligent effort to develop an

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2. The term "white knight" refers to an alternative merger partner toward whom a corporation's management is friendly.

alternative transaction by contacting other corporations potentially interested in acquiring Marathon. During the same period of time, the United States Steel Corporation was seeking to diversify its holdings and was considering the acquisition of Marathon, among other investments. Steel apparently initiated the conversations with Marathon after the Mobil offer had been made. Discussions between Marathon and Steel began on November 9, 1981, and resulted in an Agreement of Merger signed on November 18. The negotiations were carried out at a time when the Mobil tender offer remained open.

The Steel tender offer was made public on November 19, 1981. Under the terms of the tender offer, Steel proposed to pay $125.00 in cash for 30,000,000 or approximately 51.12% of Marathon's outstanding shares.[3] For all other shares, both those tendered and not accepted, and those not tendered, Steel proposed a subsequent merger between Marathon and a wholly-owned subsidiary of Steel whereby each share of Marathon stock would be exchanged for a 12½%, twelve-year note of Steel with a face value of $100.[3]

Fifty-three million, eight-hundred eighty thousand, three hundred-sixty (53,880,360) Marathon shares, representing 91.18% of the total outstanding, were tendered in response to U.S. Steel's offer.[4] On March 11, 1982, the merger of Marathon and a wholly-owned subsidiary of Steel was ap-

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3. No precise value can be placed on these securities. At the end of 12 years, they will be exchangeable at par. At the time of the merger agreement, their value was deemed to be $86.00.

4. The original period for the U.S. Steel tender offer was extended by The United States Court of Appeals for the Sixth Circuit in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981). In that action, Mobil challenged certain options granted to U.S. Steel in the Agreement of Merger. Under the Agreement, U.S. Steel was granted an option to purchase up to 10,000 common shares of Marathon for $90.00 per share, and an option to purchase Marathon's interest in the Yates Field for $2.8 million, if U.S. Steel's tender offer failed and another corporation succeeded in acquiring a majority interest in Marathon. The United States Court of Appeals for the Sixth Circuit invalidated these "lock-up options" under § 14(e) of the Exchange Act. 15 U.S.C. § 78n(e)(1981).

proved at a Marathon shareholders' meeting by the required two-thirds majority.[5] The second step of the Marathon-Steel Merger Agreement was subsequently carried out as planned.

Shareholders were first advised of the existence of the internal and First Boston asset valuations in the proxy statement relating to the merger vote, dated February 8, 1982. The proxy statement disclosed the range of net equity values of Marathon per share arrived at by each of the reports, and contained a disclaimer by the Board in each instance as to the reliability and relevance of the reports.[6]

Plaintiffs brought a class action, alleging, *inter alia*, various violations of the federal securities laws. Defendants have now moved for summary judgment with respect to those federal securities laws claims. The allegations at issue involve four main assertions, each of which will be dealt with separately.

Effect of Denial of Preliminary Injunction

This Court has previously denied plaintiffs' Motion for a Preliminary Injunction in this matter. *Radol v. Thomas*, 534 F.Supp. 1302 (S.D.Ohio 1982). Many, if not all, of the issues involved in the present motion were considered by the Court in connection with that earlier motion. It should be noted, however, that the applicable legal standard in considering a Motion for Preliminary Injunction—strong or substantial likelihood or probability of success on the merits—differs from the summary judgment standard. Therefore, the Court's earlier opinion does not necessarily control its consideration of this motion. See *Radol, supra* at 1318 (limited nature of Court's decision).

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5. On March 9, 1982, this Court denied a Preliminary Injunction to enjoin the proposed merger. See *Radol, supra*.

6. Specifically, the Board stated that the reports "were not viewed by Marathon's Board of Directors as being reflective of, and do not represent, per share values that could realistically be expected to be received by Marathon or its shareholders in a negotiated sale of the company as a going concern or through liquidation of the company's assets." (Pltfs.' Ex. I(D) p. 13).

Summary Judgment Standard

The summary judgment standard in this Circuit is a stringent one. Federal Rule of Civil Procedure 56(c) permits the Court to grant summary judgment only when there is no genuine issue of material fact and when the moving party is entitled to judgment as a matter of law. *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620, 64 S.Ct. 724, 88 L.Ed. 967 (1944); *Watkins v. Northwestern Ohio Tractor Pullers*, 630 F.2d 1155, 1158 (6th Cir. 1980). The Court may not make findings of disputed facts on a Motion for Summary Judgment. *Watkins, supra.* The movant has the burden of showing conclusively that there exists no genuine issue as to a material fact, and the evidence together with all inferences to be drawn therefrom must be considered in the light most favorable to the party opposing the motion. *Id.* The movant's papers are to be closely scrutinized, while those of the opposing party are to be viewed indulgently. *Id.* The Court will consider this Motion in accordance with the foregoing considerations.

Two-tier Merger As A Manipulative Device

Defendants seek summary judgment on plaintiffs' claim that the two-tier merger of Marathon and Steel was coercive and a manipulative device, in violation of Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e), and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b).[7] Plaintiffs assert that there

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7. Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 14(e) provides, in pertinent part

> It shall be unlawful for any person to make any untrue statement of a

exist genuine issues of material fact with respect to this issue. The Court disagrees.

Plaintiffs' claim centers on the contention that the disparity in value between the $125.00 per share offered on the front end of the merger arrangement and the Steel notes exchanged on the back end acted to coerce Marathon shareholders into tendering at the front end in order to avoid a later freeze out at the lower value. This alleged coercion, according to plaintiffs, acted as a manipulative device in violation of §§ 10(b) and 14(e) by effectively depriving Marathon shareholders of the option of holding their shares for long-term appreciation and by contributing to "inefficiency in investment decisions." Plaintiffs rely on *Mobil Corp. v. Marathon Oil Co., supra,* in which The United States Court of Appeals for the Sixth Circuit held that two options granted by Marathon to Steel as part of the original merger agreement constituted "manipulative devices" in violation of § 14(e).

Plaintiffs reliance on *Mobil* is misplaced. The options involved in that case were an irrevocable option to purchase 10 million authorized but unissued shares of Marathon stock and an option to purchase Marathon's 48% interest in oil and mineral rights in the Yates Field. This latter option could be exercised only if Steel's offer did not succeed and a third party acquired control of Marathon. Thus, in effect, a competing offeror was precluded from acquiring Yates Field in a merger with Marathon. *Mobil, supra,* at 367. The Court concluded that these options prevented all other potential offerors from competing on equal footing with Steel, *id.* at 375, 376, and stated that the options, individually and in tandem, had the effect of "circumventing the natural forces of market demand in this tender offer contest." *Id.* at 376. The Court also held

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material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

that the fact that the options were fully disclosed did not prevent their being "manipulative devices" in violation of § 14(e). *Id.* at 376-77. The Court concluded its discussion with a word of caution:

> In so ruling, we do not purport to define a rule of decision for all claims of manipulation under the Williams Act, or indeed for all forms of options which might be claimed to "lock up" takeover battles or otherwise discourage competing tender offers. *Id.* at 377.

The situation at bar is not governed by *Mobil*. The two-tier tender offer and merger at issue here did not "circumvent the natural forces of market demand" in the manner of the options in *Mobil*.

As this Court has noted, any tender offer is likely to be coercive to some degree. *Radol, supra*, at 1312. The degree of "coerciveness" may increase as the disparity between the front end and back end of the transaction grows. Yet the Court is aware of no case in which such a disparity has been the basis for a finding of a violation of § 10(b) or § 14(e).

It is also clear that the two-tier arrangement did not discourage competing offerors. Mobil, in fact, responded to Steel's offer with an offer of its own, similar in price and structure. *See, Radol, supra*, at 1313.

While it may be true that "[t]he methods and techniques of manipulation are limited only by the ingenuity of man," *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971), *cert. denied*, 406 U.S. 932, 92 S.Ct. 1770, 32 L.Ed.2d 135 (1972), it remains the case that "manipulation is virtually a term of art when used in connection with securities markets. The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476, 97 S.Ct. 1292, 1302, 51 L.Ed.2d 480 (1977) (citations omitted). The term does not cover all situations where shareholders may have been treated unfairly, *id.* at 477, 97 S.Ct. at 1302, and it does not cover the two-tier tender offer and merger at issue here.

This conclusion is buttressed by the fact that Congress has, by implication, acknowledged the existence of two-tier transactions and has regulated but not outlawed them, *see* 17 C.F.R. § 240.13e-3, and by the fact that the Court in *Mobil*, *supra*, allowed this very arrangement to proceed after striking out the invalid options. *See generally Radol*, *supra*, at 1312-13.

On this issue, defendants' Motion for Partial Summary Judgment will be granted.[8]

Tender Offer Material As Proxy Solicitations

Defendants also seek summary judgment on plaintiffs' claim that defendants' communications at the time of the tender offer are, in effect, proxy solicitations which violate § 14(a), 15 U.S.C. § 78n(a).[9] Plaintiffs first note defendants' argument that the two-tier tender offer and merger arrangement must be considered a unitary transaction for purposes of assessing the fairness of the deal. Plaintiffs then contend that the arrangement must also be considered a unitary transaction with respect to the application of proxy rules. They argue that, as a practical matter, shareholders were faced with the decision of whether to approve the merger at the time of the tender offer. Therefore, the materials disseminated by defendants in connection with the tender offer were, in effect,

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8. Plaintiffs argue that several individuals' opinions that the arrangement here was "coercive" or "manipulative" provide triable issues of fact which preclude summary judgment. This is not the case. The material facts are the details of the two-tier transaction, which are undisputed. The question of whether these facts constitute manipulative acts or practices is a question of law, amenable to disposition by summary judgment.

9. Section 14(a) provides

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 781 of this title.

proxy solicitations. The Court disagrees with plaintiffs' reasoning.

While it may be appropriate to consider the two-step transaction as unitary for the purpose of assessing its fairness,[10] it does not follow that it should be considered unitary with respect to the application of the proxy rules of § 14(a).

In evaluating the fairness of the choice confronting shareholders, it is clear as a matter of logic that the two options must be considered together. Shareholders were free either to tender or to accept the terms of the merger. Fairness must therefore be considered in the context of both available options, considered as a whole.

However, as this Court has previously noted, "a tender offer and subsequent merger are distinct acts with separate concerns toward which the securities laws and SEC Rules are directed in their regulatory schemes." *Radol, supra*, at 1314. Therefore, it is entirely appropriate to consider each step in such a transaction separately.

It is clear that the statements made in the tender offer and in the November 19, 1981, letter to Marathon shareholders from Director Hoopman were made in compliance with the securities laws and SEC Rules pertaining to tender offers. *Id.* As the Court has stated,

> To comply with these rules, U.S. Steel and Marathon referred to the merger agreement which would be proposed if the tender offer was successful. These references were not the equivalent of solicitations for the merger which would call forth application of the full panoply of the proxy rules. The proxy rules were applicable only when the merger step of the transaction began. *See Sheinberg v. Fluor Corp.*, 514 F.Supp. 133, 138 (S.D.N.Y. 1981). *Id.* (footnote omitted).

Here again, summary judgment is appropriate. The "ma-

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10. The Court expresses no opinion on the fairness of the transaction, an issue not before it at this time.

terial facts" are the tender offer and the materials distributed in connection therewith. The dispute involves a purely legal question. On this claim, defendants' Motion will be granted.

Rule 13e-3 and the Tender Offer

The third issue on which defendants seek summary judgment involves plaintiffs' claim that SEC Rule 13e-3[11], dealing with going private transactions, applied to the tender offer stage of the two-tier arrangement and required disclosure, at that time, of the First Boston and internal valuations, and plaintiffs' claim that the fairness opinions required by that Rule to be contained in the proxy statement were inadequate. On these claims, the Court finds that defendants are entitled to summary judgment.

As noted in *Radol, supra*, at 1304, it is undisputed that Rule 13e-3 applied to the merger stage of this transaction, and that defendants purported to comply with the Rule in their proxy satement. Plaintiffs claim, however, that the Rule also applied to the tender offer stage and required disclosure, in Steel's tender offer and supporting solicitations, of the First Boston and internal valuations.

Rule 13e-3 prohibits "fraudulent, deceptive or manipulative acts or practices," in connection with a going private transaction, by the issuer or an affiliate of the issuer, and sets forth certain requirements pertaining to filing, disclosure and dissemination of information in connection with such a transaction. *Radol, supra*, at 1310. *See also* 17 C.F.R. § 240.13e-3. "Affiliate of an issuer" is defined as

> A person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with such issuer. *For the purposes of this section only, a person who is not an affiliate of an issuer at the commencement of such person's tender offer for a class of equity securities of such issuer will not be deemed an affiliate of such issuer prior to the stated termination of*

11. 17 C.F.R. § 240.13e-3.

> *such tender offer and any extensions thereof.* 17 C.F.R. § 240.13e-3(a)(1) (emphasis added).

Plaintiffs contend that Steel was an affiliate of Marathon because, one day prior to the commencement of the tender offer, Steel allegedly acquired the requisite control over Marathon by means of the merger agreement entered into by the two companies. Additionally, they argue that the issue of control involves a factual determination which precludes the granting of summary judgment. In so arguing, they rely on SEC Release No. 34-17719, [1981] 2 Fed.Sec.L.Rep. (CCH) ¶23,709, which states:

> The existence of a control relationship with [the target company] does not turn solely upon the ownership of any specific percentage of securities. Rather, the question is whether there is the ability, directly or indirectly, to direct or cause the direction of the management and policies of [the target company], whether through the ownership of voting securities, *by contract* or otherwise. Id. at pp. 17, 245-35 and 36, n. 28 (emphasis added).

Plaintiffs argue that the negative covenants contained in the merger agreement gave Steel control over Marathon "by contract" within the meaning of the language quoted above.

The Court disagrees and holds that, as a matter of law, the negative covenants in question did not create in Steel a sufficient "ability, directly or indirectly, to direct or cause direction of the management and policies" of Marathon to rise to the level of control. Those covenants essentially required Marathon only to refrain from extraordinary corporate activity pending the merger and to use its best efforts to preserve intact its business organization. *Radol, supra,* at 1310. *See also id.* at n. 7 (description of specific convenants.)

Since Steel did not control, and was therefore not an affiliate of, Marathon at the commencement of the tender offer, Steel falls within the explicit exception created by the second sentence of Rule 13e-3(a)(1). As a result, Steel was not

an affiliate of Marathon during the period of the tender offer, and Rule 13e-3 did not apply to that stage of the transaction. Consequently, that Rule did not require disclosure of the First Boston and internal valuations at that time.

Plaintiffs also claim that the "fairness opinions" disclosed in the proxy statement by defendants pursuant to Rule 13e-3[12] were inadequate. They argue, in essence, that the fairness opinions[13] related to the transaction as a whole and not to the merger *per se* and were therefore misleading.

This issue was considered in *Radol*, *supra*, 1316-17. Upon re-examination, the Court finds no reason to deviate from that reasoning, which will not be repeated here. The Court concludes that the fairness opinions contained in the proxy materials were not materially misleading.

On the issues of the applicability of Rule 13e-3 to the tender offer and the sufficiency of the fairness opinions contained in the proxy materials, summary judgment will be granted for defendants.

Failure to Disclose Asset Valuations Under §§ 10(b) and 14(e) and Rule 10b-5

The last major issue on which defendants seek summary judgment involves plaintiffs' contention that the failure to disclose the First Boston and internal asset valuations in the tender offer materials violated §§ 10(b) and 14(e) and Rule 10b-5.[14] Plaintiffs argue that the question of the materiality of

12. Rule 13e-3(e)(1) requires the disclosure of various items listed in Schedule 13e-3, 17 C.F.R. § 240.13e-3. Item 8(a) of Schedule 13e-3 requires that the proxy statement "[s]tate whether the issuer or affiliate ... reasonably believes that the Rule 13e-3 transaction is fair or unfair to unaffiliated security holders." The statement is also required to "[d]iscuss in reasonable detail the material factors upon which the belief ... is based and, to the extent practicable, the weight assigned to each such factor." *Id.* at Item 8(b).

13. For the text of the fairness opinions, see *Radol*, *supra*, at 1316.

14. Sections 10(b) and 14(e) are set out *supra*, n. 7. Rule 10b-5 provides

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails,

the asset valuations must be submitted to a jury. Defendants contend that the valuations, based as they were on imprecise calculations and predictions, did not, as a matter of law, rise to the level of materiality. Here, in the context of a summary judgment motion, the Court agrees with plaintiffs.

As is evident from the language of § 14(e) and Rule 10b-5, omissions must involve *material* facts in order to be actionable. In *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 450, 96 S.Ct. 2126, 2132-33, 48 L.Ed.2d 757 (1976), the Supreme Court discussed materiality,[15] stating

> The issue of materiality may be characterized as a mixed question of law and fact, involving as it does the application of a legal standard to a particular set of facts. In considering whether summary judgment on the issue is appropriate, we must bear in mind that the underlying objective facts, which will often be free from dispute, are merely the starting point for the ultimate determination of materiality. The determination requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. (footnotes omitted).

The *Northway* Court also formulated a general standard of materiality:

> An omitted fact is material if there is a substantial like-

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or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

15. *Northway* involved Rule 14a-9, 17 C.F.R. § 240.14a-9. However, the language of that Rule mirrors the operative language here in all significant respects and the *Northway* discussion is pertinent. *See, e.g., James v. Gerber Products Co.*, 587 F.2d 324, 327 (6th Cir. 1978).

> lihood that a reasonable shareholder would consider it important in deciding how to vote. This standard is fully consistent with *Mills*'[16] general description of materiality as a requirement that "the defect have a significant *propensity* to affect the voting process." It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available. *Id.* at 449, 96 S.Ct. at 2132 (footnote omitted).

The Court cautioned, however, that "[s]ome information is of such dubious significance that insistence on its disclosure may accomplish more harm than good." *Id.* at 448, 96 S.Ct. at 2132.

In *James v. Gerber Products Co.*, 587 F.2d 324 (6th Cir. 1978), The United States Court of Appeals for the Sixth Circuit was confronted with a case involving nondisclosure of interim earnings figures. The Court stated, "Such sales figures, projections, forecasts and the like only rise to the level of materiality when they can be calculated with substantial certainty." *Id.* at 327. Defendants place heavy reliance on this statement, arguing that the asset valuations here, involving projections of up to half a century hence, reflect too great a level of uncertainty to meet the legal test of materiality.

The Court is unconvinced that the asset valuations are, as a matter of law, not material. It is conceivable that a "reasonable shareholder" would have accorded the valuations "actual significance" in his deliberations, even if disclosure would not have altered his decision. *See Northway, supra,* at

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16. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970).

449, 96 S.Ct. at 2132. In any event, this is a question that is best left to a jury. Id. at 450, 96 S.Ct. at 2133. On this issue, defendants are not entitled to judgment as a matter of law, and summary judgment will be denied.[17]

Remaining Claims

Defendants also seek summary judgment on plaintiffs' remaining claims under the federal securities laws. The Court has examined these claims, which may be characterized as secondary, and the arguments of both sides, and concludes that, as to them, there exist no genuine issues of material fact and that defendants are entitled to judgment as a matter of law. On these remaining federal claims, summary judgment will be GRANTED.

Summary

For the reasons given above, the Court rules as follows on Defendants' Motion for Partial Summary Judgment:

With respect to the issue of whether the two-tier tender offer and merger was a manipulative device in violation of §§ 10(b) and 14(e), the Motion is hereby GRANTED.

With respect to the issue of whether the tender offer materials were proxy solicitations which violated § 14(a), the Motion is hereby GRANTED.

With respect to the issue of whether Rule 13e-3 applied to the tender offer stage of the two-tier transaction, the Motion is hereby GRANTED.

With respect to the issue of the adequacy of the proxy statement "fairness opinions," the Motion is hereby GRANTED.

With respect to the issue of the failure to disclose the First Boston and internal asset valuations at the tender offer stage, the Motion is hereby DENIED.

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17. This result is not inconsistent with the Court's earlier conclusion in *Radol, supra*. There, it was held that plaintiffs had failed to show a substantial likelihood of success on this materiality issue. *Radol, supra*, at 1308. That ruling was confined to the context of injunctive relief, *id.* at 1318, and does not dictate the decision here.

With respect to all remaining federal securities laws claims, the Motion is hereby GRANTED.

IT IS SO ORDERED.

Appendix D

Excerpt from S.E.C. Release No. 33-6332

Item 102. *Description of Property*

As the Commission has under consideration the entire area of oil and gas disclosure, it has determined to leave the Item substantially as it is at this time. Because the substance of paragraph (b) of Item 102, relating to the specific requirements for oil and gas enterprises is complex and industry-specific, the Commission is considering whether to delete it from Item 102 and to issue it as an Industry Guide. The Commission also is considering the possibility of permitting disclosure of less than proven or probable reserves with appropriate discussion. The Commission invites specific comment on these possible changes in oil and gas disclosure. It should be noted that in the interim, Instruction 4 to paragraph (b) of Item 2, relating to reserve disclosure, is proposed to be moved to new Instruction 5 to paragraph (a) and to be modified to reflect present Commission practice. As proposed to be revised, the Instruction would indicate the policy with respect to other extractive reserves, as well as oil and gas reserves, stating that except where it is shown to the staff of the Commission that reserves other than proven oil and gas reserves and proven or probable extractive reserves are required to be disclosed in the filing by foreign law or that the deletion of such reserve disclosure would render the document materially misleading, only proven oil and gas reserves and proven or probable extractive reserves may be publicly disclosed in a filing with the Commission. These limited exceptions are consistent with present staff practices. It should be noted that reliance on such exceptions will continue to require prior consultation with the Commission's staff.

The other changes proposed to the Item include a reorganization of the introduction and notes to paragraph (b) and a revision of paragraph (b) to call for three year information, rather than the five years currently required. The latter

change is intended to conform the Item to the recent changes made in Regulations S-K and S-X [17 CFR 210] to require three year segment information and income statements.[20]

20. Accounting Series Release No. 279 (September 2, 1980) [45 FR 63630].

Supreme Court, U.S.
FILED
JAN 18 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1030

IN THE

Supreme Court of the United States

October Term, 1985

IRVING and CHARLOTTE RADOL, *et al.*,

Petitioners,

v.

W. BRUCE THOMAS, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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Counterstatement of the Question Presented for Review

Does this Court's opinion in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), require a court of appeals to overturn a jury verdict that the nondisclosure during a tender offer of speculative, future-oriented, asset evaluations, which were prepared as optimistic selling tools, did not violate §§ 10(b) or 14(e) of the Securities Exchange Act of 1934?

Statement of the Parties To This Proceeding

Respondent Marathon Oil Company is now a wholly-owned subsidiary of Respondent United States Steel Corporation, and portions of its business are operated as separate, wholly-owned subsidiaries of United States Steel Corporation. In addition to its wholly-owned subsidiaries, Marathon Oil Company is affiliated with the following entities:

Arctic LNG Transportation Company
Badger Pipe Line Company
City Point Oil Terminal, Inc.
CLAM Petroleum Company
Cook Inlet Pipe Line Company
Deutsche Transalpine Olleitung GmbH
Explorer Pipeline Company
Gravcap, Inc.
Green Bay Terminal Corporation
Kenai LNG Corporation
LOCAP, Inc.
LOOP Inc.
Oasis Oil Company of Libya, Inc.
Oil Insurance Limited
Petroleum Terminals, Inc.
Pilot Oil Corporation
Platte Pipe Line Company
Polar LNG Shipping Corporation
Russell Stewart Oil Co.
Societa Italiana Per L'Oleodotto Transalpino, S.p.A.
Transalpine Finance Holdings S.A.
Transalpine Olleitung in Osterreich GmbH
West Shore Pipe Line Company
Wolverine Pipe Line Company

In addition to subsidiaries which are wholly-owned, including Marathon, Respondent United States Steel Corporation is affiliated with the following entities:

Athlone Prospecting & Development Corporation, Ltd.
First National Bank (Albion, Pa.)

Companhia Meridional de Mineracao
Brazaco-Mapri Industries Metalurgicas S.A.
ITW-Mapri (51% owned by Brazaco-Mapri)
Mecania Walsywa, Ltda.
Companhia Siderurgica Paulista "Cosipa"
Merinds Mineracao
Mineracao Buritirama Ltda.
Mineracao Carajas, Ltda.
Mineracao Maraba, Ltda.
Mineracao Xingu, Ltda.
Termerid Mineracao, SA
Torremco Soc. Min. E. Com. Ltda.
Deepsea Ventures, Inc.
Ocean Mining Associates
FHS Stahlverformung GmbH
FHS Automotive Parts Manufacturing Ltd.
Industria de Tubos y Perfiles, S.A. (Intuperas)
Minerales Ordaz C.A.
Les Entreprises du Lac Lucault Inc.
Sidbec-Normines, Inc.
U.S. Steel France
Zaerust Chrome Mines, Limited
Northern Tier Pipeline Co.
USS MaxTech Company, Inc.
USS MaxTech Company, Ltd.
USS Max Tex Company (Japan), Ltd.
USS Technology (Japan), Ltd.
ACE Holdings, Ltd.
Adela Investment Company, S.A.
Altos Hornos de Viscaya, S.A. (AHV)
Associated Ore & Metal Corporation, Ltd.
Avsteel SWA, Ltd.
Blue Grass Phosphate Company
Chrome Deposit Corp. (Court Holdings J.V.)
Jupiter Mining and Prospecting Co. (Pty.) Ltd.
Kappa Mining & Prospecting Co., Ltd.
La Pointe Iron Company
Navios Corporation

Navios Ship Management Services, Inc.
Oresteel Investments (Proprietary), Ltd.
P.T. Pacific Wikkel Indonesia
Sigma Mining & Prospecting Co. (Pty.) Ltd.
Societe Des Mines De Fer De Guinea Pour L'Exploitation Des Monts Nimba (Mifergui Nimba)
Tilden Iron Mining Company
West Union Canal Company, The
Bartow Chemical Products
Century III Associates
Fort Meade Chemical Products
Double Eagle Steel Coating Co.
Live Oak Uranium Operations
Rockland Joint Venture
RMI Company
Tenneco/USS Chemicals Joint Venture

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IN THE

Supreme Court of the United States

October Term, 1985

No. 85-1030

IRVING and CHARLOTTE RADOL, *et al.*,
Petitioners.

v.

W. BRUCE THOMAS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR THE RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the Court of Appeals for the Sixth Circuit is reported at 772 F.2d 244. That court's decision in a companion case, *Starkman* v. *Marathon Oil Co.*, is reported at 772 F.2d 231. Both opinions, together with the district court's decision on summary judgment, reported at 556 F. Supp. 586, are attached to the petition.

Statutes and Regulations Involved

The following statutes and regulations are cited in this Brief and reproduced in the Appendix:

Securities Exchange Act of 1934:

§ 10(b), 15 U.S.C. § 78j(b) 1A
§ 14(e), 15 U.S.C. § 78n(e) 1A
§ 23(a)(1), 15 U.S.C. § 78w(a)(1) 2A

Rules and Regulations:

SEC Rule 13e-3, 17 C.F.R. § 240.13e-3 2A
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I.

Statement

A. Introduction

Petitioners would have this Court believe that the court of appeals below fashioned some broad policy statement regarding disclosure of asset valuations which is contrary to this Court's decision in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976) ("*TSC*"), and the decision of the Third Circuit in *Flynn* v. *Bass Brothers Enterprises, Inc.*, 744 F.2d 978 (3d Cir. 1984) ("*Flynn*") (a case decided *after* trial below), and which is inimical to the best interests of shareholders generally. They invite this Court, rather than deciding this case on its facts, to articulate "[a] fair, coherent, and consistent standard . . . as to when [asset] valuations should be disclosed." (Pet. 6).

In truth, the court of appeals properly confined its decision to the case before it and found, in a manner

entirely consistent with *TSC* and *Flynn*, that petitioners' claim of securities fraud should not have been submitted to the jury in the first instance. That claim involved the nondisclosure, during a tender offer by United States Steel Corporation ("U.S. Steel") for 51% of the shares of Marathon Oil Company ("Marathon" or the "Company"), of two "selling documents" containing speculative evaluations of Marathon assets, which have become known as the First Boston Report and the Strong Report. The court of appeals rejected the claim under both *TSC* and the uniform body of case law which existed at the time and which held that speculative appraisals, forecasts, and projections are not "material facts" required to be disclosed to investors under the federal securities laws.

The *Flynn* case, decided in 1984, recognized the uniform rule and its application in prior decisions of the Third Circuit and elsewhere. It remains to be seen whether the test for disclosure of certain "soft" information announced in *Flynn* will prove to be any different in application from the prior articulations of the rule. Even if *Flynn* is subsequently viewed as adopting a different rule, it does not create a conflict with the Sixth Circuit's decision in this case. That is because the *Flynn* court announced that its rule was to be applied prospectively only. Nevertheless, even if the rule were applied to the Strong and First Boston Reports involved here, the result would be the same.

The petition focuses only on the portion of the jury charge entitled "Representations Concerning the Future." While this charge was manifestly correct, petitioners' isolation of one portion of the charge distorts the whole of the charge on materiality and on petitioners' nondisclosure claim generally. See Appendix for the entirety of the district court's charge on materiality. The district court began its instructions by quoting the pertinent portions of the governing statutes and rules (including those portions making it unlawful to "omit to state a material fact necessary in order to make the statements

made in the light of the circumstances under which they were made not misleading"), and by stating that the purpose of Congress in enacting these provisions was "to require a policy of full disclosure." (Tr. 2645). The court then set forth the elements of a claim under these provisions. In its discussion of these elements, the court instructed the jury that they must "determine whether the omission of the Strong or First Boston Reports constituted a failure to disclose a material fact" and that "an omitted fact is material if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to tender his stock." (Tr. 2648). In addition, the court instructed on the law applicable to projections and forecasts. (Tr. 2647-48). The language of the court's instructions closely tracks this Court's decision in *TSC* and the clear weight of authority from other courts.

Applying this charge to the evidence at trial, the jury's verdict is hardly surprising. Rather than the objective, expert appraisals painted by petitioners, the jury was presented with evidence demonstrating that the Strong and First Boston Reports are paradigms of the type of speculative, future-oriented information which is "of dubious significance that insistence on its disclosure may accomplish more harm than good." *TSC*, *supra*, 426 U.S. at 448.

In sum, there is here neither a departure from the rule embodied in the decisions of this Court nor a clear and existing conflict among the circuits. This is not, therefore, an appropriate case in which to reconsider the disclosure requirements of the federal securities laws or to promulgate general rules concerning the materiality of theoretical asset valuations. Supreme Court Rule 17.

B. The Origins of the First Boston and Strong Reports

In mid-July 1981 Marathon[1] asked its financial advisor, The First Boston Corporation ("First Boston"), to prepare a review of the Company's assets, using publicly available information, to be used in the event of an inadequate tender offer for the Company. First Boston presented its results orally to the Marathon Board on October 31, 1981, the day after Mobil Corporation ("Mobil") had announced a hostile tender offer to purchase 68% of Marathon's shares at a price of $85 per share. A written draft of the review was presented to the Board on November 5, 1981. First Boston cautioned the Board that the projections in its Report, which contained per share figures of $188 and $226, should not be confused with the price which could actually be obtained for Marathon as a going concern or in liquidation. (*E.g.*, Tr. 833-34, 865-66, 890-91, 1921-22). That caution sprang from the reality of the marketplace: market analysts had published numerous, theoretical asset valuations of petroleum companies, including Marathon, in the same range as the First Boston and Strong Reports, but Marathon's stock had closed at $63.75 per share the day before the Mobil offer and had never traded anywhere near the range of those theoretical valuations. (DX 858; Tr. 244-49, 1401-02).

The jury also learned that the Strong Report had been initiated in the summer of 1981, when Marathon's President, Mr. Hoopman, asked each operating division to compile a catalogue of its assets with optimistic projections of value to use to attract alternate bids in the event of an inadequate tender offer. As the court of appeals noted,[2] the Strong Report, like the First Boston Report, was not prepared in the ordinary course of business but

1. Marathon was a publicly-owned Ohio corporation engaged in all phases of the petroleum industry and had over 58,600,000 shares of common stock outstanding, held by over 35,000 shareholders. Marathon ranked 38th on the then-current *Fortune* 500 list.

2. The Strong and First Boston Reports are discussed extensively in the companion case to this one, *Starkman* v. *Marathon Oil Co.*, 772 F.2d 231, 233-35 (6th Cir. 1985), *pet. for cert. filed*, No. 85-1029 (Dec. 13, 1985). Petitioner in that case does not seek review of that portion of that decision.

was instead a "selling document." In that vein, Mr. Hoopman told his people to "take off your engineers' hats and put on your sales hats" and to look at the assets through "rose-colored glasses" when assigning values.[3] (Tr. 675, 885, 1626-28, 1631-33, 2109, 2143). Consistent with Mr. Hoopman's mandate, the Strong Report arrived at per share figures of $276 and $323 for Marathon's assets.

C. The Contents of the Reports

In light of the market price of Marathon shares before the Mobil offer, compared to publicly-available theoretical asset values in the same range as the Reports, it is hardly surprising that petitioners made no effort at trial to demonstrate that anyone believed that shareholders could hope to realize any price in that range for their shares. Indeed, petitioners' own expert testified that an asset evaluation does not reflect the fair market value of a company's stock and that there is not even any clear relation between the two. (Tr. 1031-32).

Moreover, the evidence showed that the asset values themselves were highly speculative and inaccurate. Oil and gas reserves were assigned values in the Reports based on discounted cash flows ("DCF").[4] At the beginning of

3. Petitioners quote an excerpt from a letter of Marathon's general counsel, Mr. Hampton (Pet. 10), to convince this Court that the Strong Report was intended to be an estimate of present market value. The jury plainly rejected that contention after hearing all the evidence, particularly that which showed that Mr. Hampton's letters were intended to bring proprietary information within the attorney-client privilege and not to countermand Mr. Hoopman's prior instructions to use "rose-colored glasses."

4. Petitioners make the statement that "the uncontradicted evidence was that investment analysts and others routinely consider valuations like those involved here to be important in making business decisions . . . ." (Pet. 6). That statement is both inaccurate and irrelevant. At best, the record below would support a claim that persons in the oil and gas business, who appreciate the limitations of such analyses, frequently use a DCF analysis, together with other information, when evaluating oil and gas properties. There was no showing, nor could there be, that anyone would employ the same highly optimistic assumptions and predictions which went into the DCF sections of the Reports in making unspecified "business decisions."

a DCF, an estimate is made of the oil and gas reserves in each of the Company's fields. The useful life of the field is then estimated, and a forecast is prepared of how much oil may be extracted from that field in each year of its useful life.[5]

To forecast future gross revenues to be received from the oil or gas which it is estimated will be extracted from a particular field in each year of the field's useful life, a projection must be made of the price to be received for each product in each year of the useful life of a field (which can be 50 years or more). Price projections of equally qualified economists differ widely for any year, and such differences have an enormous impact on succeeding stages of a DCF.

After calculation of projected annual gross revenues by multiplying the predicted price by the estimated number of barrels of oil to be produced in that year, net revenues in any year are calculated by subtracting estimates of the capital and expenses involved in the extraction of that oil.[6] After net reserves are estimated, the DCF methodology requires the selection of a discount rate to reduce estimated future net revenues to a present value. The choice of a rate is highly subjective, and analysts differ on appropriate rates and the factors used to select the rate. The rate has a very significant impact on the resulting present value.[7]

5. As the jury heard, how much oil will be produced in a year from a particular field depends not only on geologic estimates but on a forecast of market demand in that year, whether the owner will have the funds needed to extract the oil in that year, and whether the price for oil justifies the production costs. For those states which regulate extraction rates, the rate which will be permitted in that year must be predicted.

6. Those estimates, in turn, depend on estimates of the cost of money, the availability and price for steel, labor and energy and on forecasts of future government taxation policies.

7. For example, a difference of 3 percentage points in the alternate discount rates presented in the Strong Report resulted in a difference of $2 billion.

As the evidence established, DCF methodology is highly speculative and its results are susceptible to manipulation in the choices of the many estimates and outright guesses necessarily incorporated in it. The jury heard much evidence that the estimates chosen were consistent with the selling document purpose of the Reports. For example, the Strong Report assumed that the State of Texas would permit Marathon to increase its extraction of oil from its most important domestic reserve, the Yates Field, by 25,000 bbls./day. In fact, Marathon never received that permission, and the Report's projection of gross production from Yates was overstated by 9,000,000 bbls./year as a result of that single optimistic but erroneous prediction.[8]

By definition, the existence of, and ability to extract, probable reserves is even more uncertain than proven reserves. Yet no risk factors were applied to the present values assigned to probable reserves in the Strong Report; they were treated precisely the same as proven reserves. While geologic risk factors were used in the DCF evaluation of potential reserves, a host of other uncertainties was not factored into the values assigned those prospects in the Strong Report. Many of the potential reserve projects were jointly owned by Marathon and other oil companies, whose approval for exploration, though necessary, had, in many cases, not yet been sought. Contrary to normal budget practices, the Report assumed unlimited funds to conduct exploration and development programs simultaneously on all predicted schedules.

While the jury heard evidence of many other optimistic and even unrealistic assumptions,[9] one further example regarding domestic oil and gas properties should suffice.

8. Similarly, the First Boston Report contained an erroneous assumption that the Yates Field contained 150,000,000 bbls. of recoverable oil that had not been publicly reported. After delivery of the First Boston Report, it was discovered that Marathon had already publicly reported those reserves and, thus, that the Report had erroneously "double-counted" them.

9. The First Boston Report used crude oil price projections which by the fall of 1981 were already known to be too high.

Values were assigned to estimated reserves for prospects where Marathon had not yet acquired any drilling rights. Simply stated, the Report listed as assets of Marathon, and ascribed values thereto, potential reserves which, if they existed at all, Marathon did not even own but only hoped it could acquire in the future.

Much the same optimism was shown regarding Marathon's international oil and gas reserves. Petitioners' expert conceded that "all foreign oil and gas assets were overstated." (Tr. 1295-96). No attempt was made in the Strong Report to distinguish the different political risks attendant to hypothetical future revenue streams from countries with vastly different political and economic regimes. For example, no distinction was made between projected future revenues from Marathon's estimated reserves in the United Kingdom and those from its unsaleable estimated reserves in Col. Qaddafi's Libya, which were valued at approximately $1 billion.

The per share values in the Reports also rested on valuations of other assets not prepared using a DCF analysis. Refineries were valued at the undepreciated cost of replacing them in their existing configurations, notwithstanding that their market values were significantly less. Similarly, values assigned to Marathon's pipelines and ships, mainly replacement values, were known to be unrealizable in a sale and were conceded by one of petitioners' experts to be "overstated" and not a reflection of fair market value. (Tr. 1295). In addition, whole pipeline systems owned or partially owned by Marathon and its interests in certain marketing and foreign affiliates were erroneously double-counted. The balance sheet adjustment portion of the Strong Report failed to set off hundreds of millions of dollars of liabilities, and the DCF evaluations, themselves, failed to net out almost $500 million in pre-tax annual overhead and interest expenses.

It is also important to note that neither Report contained any significant factual information not already in the public domain. The First Boston Report was ad-

mittedly derived from publicly available information. That Report added only First Boston's DCF projections, which were of a kind any analyst could have made, and many did make, on the basis of the same public information. In view of the wealth of information disclosed in Marathon's Annual Reports, the same can be said about the Strong Report. There was no evidence that the Strong Report revealed some important asset of Marathon which had never been publicly disclosed. There were no secret oil discoveries revealed for the first time in the Report.

The complaint, in footnote 12 of the petition, that "the Sixth Circuit nowhere explained why defendants were not obligated to disclose the asset valuations at least to the extent of Marathon's *proven* reserves," rings somewhat hollow in view of the estimates of Marathon's proved reserves, with values assigned in accordance with requirements of the Securities and Exchange Commission ("SEC"), which appeared in Marathon's Annual Reports.[10]

D. Use of the Reports

Both the First Boston and Strong Reports were discussed with the Marathon Board at its October 31, 1981 meeting to consider the Mobil tender offer. First Boston advised the Board that Marathon could not expect to receive a price which resembled the theoretical asset values and that such values would not be important or helpful in obtaining a higher bid. The Marathon employees who discussed the Strong Report told the Board it was a selling tool and made clear that its projections were not intended to, and did not, represent the price that could be realized in a sale of Marathon as a going concern or in liquidation.

10. Marathon's public reports contained hypothetical values for its assets prepared in accordance with SEC requirements which were very different from the assumptions employed in the Strong Report. For example, in its Annual Reports, Marathon presented a DCF analysis of proved reserves which complied with the SEC requirement that the price of oil be held constant at its existing level. The DCF in the Strong Report assumed that oil prices would constantly increase for up to 20 years in the future, reaching in excess of $200/bbl.

The jury learned that, despite their resolve to oppose Mobil's tender offer on all legitimate fronts, the Marathon respondents did not, in that effort, disclose the speculative values contained in the Reports to the shareholders for fear of misleading them. Petitioners' own expert recognized that "selling documents" are frequently prepared by companies facing tender offers and should not be disclosed publicly. (Tr. 1290-97).

In an effort to develop a better alternative to Mobil's bid, Marathon attempted to use the Reports to interest potential bidders, but the jury learned that the recipients of the Reports dismissed them as mere sales tools and that, of the comparatively few bids advanced, none was based on the values contained in the Reports.

For its part, U.S. Steel placed no reliance on either Report. While Mr. Corry of U.S. Steel reviewed briefly the Executive Summary of the Strong Report, he dismissed it as a "trumped-up piece of junk," and it played no role in his evaluation of Marathon or the formulation and approval of the U.S. Steel proposal by management and the Board of Directors. (Tr. 313-14, 389). What U.S. Steel did find useful were Marathon's 5-year earnings projections, which it subsequently disclosed to shareholders in its offering materials.

The agreement between Marathon and U.S. Steel announced on November 19, 1981 provided that U.S. Steel would make a tender offer for 51% of Marathon's outstanding shares at $125 per share. Thereafter, the shareholders would be asked to approve a merger, in which each remaining share would be exchanged for a $100 principal amount, 12 year, 12½%, guaranteed Note.[11] Because the Reports

11. The Notes are publicly-traded. Their market price fluctuates in a generally inverse relationship to prevailing interest rates. At the time the agreement between Marathon and U.S. Steel was announced, their estimated trading price was $86. At the time of the merger, they were trading at $76. But, on May 6, 1983, just prior to trial, they were trading at $103⅞.

The price received by Marathon shareholders after they had accepted U.S. Steel's offer represented a 76.7% premium over the

(footnote continued on next page)

were potentially misleading selling documents which had not been relied upon by either Marathon or U.S. Steel, neither Report was disclosed in the tender offer materials.

After the tender offer was completed, a Proxy Statement was sent to Marathon's shareholders in connection with the proposed merger of Marathon into U.S. Steel. The merger was technically a "going private" transaction subject to SEC Rule 13e-3, 17 C.F.R. § 240.13e-3, which required disclosure of, *inter alia*, "outside appraisals," regardless of their materiality. Because the First Boston Report arguably fell within that provision of Rule 13e-3, it was disclosed in the Proxy Statement, and, under those circumstances, the Strong Report was also disclosed, with appropriate disclaimers as to reliability.

Contrary to petitioners' theory, after disclosure of the Reports, U.S. Steel's stock fell both absolutely and in relation to the market. (Tr. 1409-10, 1416-30; DX 884-90).

E. Treatment of the Reports in the Courts Below

To summarize the evidence heard by the jury in the district court, there was:

- clear and undisputed evidence of the uncertain and unrealistic methodologies employed in the Strong and First Boston Reports to project asset values;
- clear and undisputed evidence of optimistic and unapparent assumptions, shortcomings, contraindications, and outright errors which underlay the application of those methodologies in this instance;

1981 average trading price of Marathon stock and was higher than the premium paid in 73.5% of the contested tender offers and 95% of the uncontested tender offers between 1979 and March 10, 1982. It was the highest premium paid in any acquisition of an oil company during the period, including the DuPont acquisition of Conoco. Petitioners state that this case "arises out of the extinction of the rights of thousands of class members . . . ." (Pet. 3). In fact, the shareholders of Marathon overwhelmingly and voluntarily decided to sell their shares for the price offered by U.S. Steel. As one of the petitioners was himself advised by his counsel of record in this case: "It is a great deal. Take it." (Tr. 1981).

- admission by petitioners' expert that the asset values contained in the Reports were not values that could be realized in a sale of Marathon's assets and did not reflect the fair market value of Marathon stock (Tr. 1027, 1031-32);
- an admission by petitioners' expert that the values assigned to Marathon's oil and gas reserves were derived by a process which was not "certain or substantially certain" (*id.*);
- an admission by petitioners' expert that the values assigned to Marathon's downstream assets (refineries, pipelines, etc.) and the international oil and gas reserve portion of its upstream assets were overstated (Tr. 1295-96); and
- undisputed evidence that the values assigned to Marathon's proved domestic oil and gas reserves in the Reports were prepared in a manner inconsistent with SEC requirements, but that estimates of the quantity and value of those reserves prepared in accordance with SEC requirements had been provided to shareholders in Marathon's Annual Reports.

As discussed above, the trial court gave comprehensive instructions to the jury, including those on the issue of "materiality," which were taken directly from this Court's opinion in *TSC*, *supra*, 426 U.S. at 449.[12]

The court of appeals approved the jury instruction but noted that the district court, in its earlier refusal to grant summary judgment on the nondisclosure claim, had

12. The district court went on to instruct on the law applicable to projections and forecasts as noted on page 17 of the petition. Petitioners fail to note, however, that the court permitted petitioners to argue to the jury the meaning of the legal standard on projections contained in his charges. Petitioners took that opportunity to argue that neither Report was a prediction regarding future events and that the "substantial certainty" requirement was satisfied here by a claimed showing that the projections were prepared in good faith by qualified persons using accepted methodologies. (Tr. 2471-72, 2630-32).

employed a standard which was expressly rejected by this Court in *TSC* and that, if the proper *TSC* standard had been employed, the issue of materiality should not have gone to the jury. (772 F.2d at 252-53). The court noted that the duty to disclose "soft" information based on predictions regarding future economic and corporate events arises only if the predictions are "substantially certain to hold." (*Id.* at 253). It went on to find that "in any event . . . there was no duty to disclose the asset appraisals at issue here." (*Id.*).

II.

Summary of Argument

The decision below does not conflict with this Court's test for materiality. The Sixth Circuit held that speculative projections of the future and estimates of value based thereon need not be disclosed, unless such projections are "substantially certain to hold." Whether the Sixth Circuit's decision is viewed as a further refinement of the general materiality standard of *TSC* when speculative information is involved or a preliminary analysis of whether there is a "fact" to which the *TSC* test for materiality is to be applied, it is entirely consistent with numerous decisions before and after *TSC*, which have uniformly concluded that disclosure of the type of speculative information involved in this case is not required.

No genuine conflict between the decision below and the Third Circuit's decision in *Flynn* is presented in this case. The "test" for disclosure of soft information announced in *Flynn* in 1984 was expressly made prospective and would not be applied to the 1981 events in this case, even in the Third Circuit. The *Flynn* test has yet to be applied in any subsequent case and may turn out to be no different in application from the decision below. Even if the *Flynn* test were applied at face value to the facts of this case, the same result would be reached.

The Sixth Circuit properly understood and interpreted the applicable regulations and policies of the SEC. Under the regulations in effect at the time of U.S. Steel's tender offer, disclosure of the Strong and First Boston Reports was prohibited.

III.

Reasons For Denying The Writ[13]

A. There Is No Conflict Between the Court of Appeals' Decision and This Court's Opinion in *TSC*.

Petitioners erroneously contend that the courts below applied a standard of materiality in conflict with this Court's decision in *TSC*. The district court charged the jury in language taken directly from *TSC*, and the court of appeals expressly acknowledged the language employed by the district court from *TSC* as the correct general test for materiality. 772 F.2d at 253.

Thus, petitioners' putative conflict between *TSC* and the Sixth Circuit's decision is elusive, to say the least. It appears, however, that their argument reduces to a syllogistic claim that persons investing in oil and gas reserves routinely use appraisals, employing a DCF analysis which is inherently speculative; the First Boston and Strong

13. Respondent First Boston was Marathon's financial advisor, and respondent Goldman Sachs was U.S. Steel's financial advisor. They were joined as defendants below but dismissed prior to trial upon stipulation of petitioners. In that stipulation, petitioners reserved the right to continue this action against First Boston and Goldman Sachs only as to those claims dismissed by the district court's Order of February 1, 1983 granting partial summary judgment. Although petitioners do not seek review in this Court of any of the claims dismissed in that Order, petitioners have named First Boston and Goldman Sachs as respondents herein. Respondents have been authorized to state that First Boston and Goldman Sachs join in the arguments presented herein, by their respective counsel, Ronald S. Rolfe, Esq., Cravath, Swaine & Moore, One Chase Manhattan Plaza, New York, N.Y. 10005, (212) 422-3000 and Melvyn L. Cantor, Esq., Simpson Thacher & Bartlett, One Battery Plaza, New York, N.Y. 10005, (212) 483 9000.

Reports are such appraisals; therefore, the Reports would be material to an investor deciding to tender his shares. (Pet. 21-23). The argument is wrong in fact, logic and law.

First, as summarized previously, the Reports were not straightforward asset appraisals prepared in the ordinary course of business. There was no evidence that anyone would use selling documents filled with the optimistic assumptions and predictions in the Reports when making a decision to invest in oil and gas properties. Certainly, none of the companies provided with copies of the Reports, including U.S. Steel, considered them important—had they given them any credence, one would have expected a bidding war of historic proportions to have ensued.

Second, even if the Reports were the type painted by petitioners, it does not follow that they would be material to investors deciding whether to tender their shares.[14] The evidence which the jury heard was that the market routinely ignored the many published, speculative asset appraisals in determining the fair market value of the stock of oil and gas companies. Materiality is not simply a free-floating concept but must be determined in a particular context.[15]

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14. Indeed, it is petitioners who seek to alter the materiality standard set forth in *TSC* by arguing, in effect, that no matter how speculative or unreliable a forward-looking appraisal or estimate might be, it should be considered material as long as it might serve some business purpose in some context, no matter how unrelated. This notion is contrary to *TSC*'s focus on reasonable investors and is refuted by the cases interpreting *TSC*. *E.g., James* v. *Gerber Products Co.*, 587 F.2d 324, 327 (6th Cir. 1978); *Vaughn* v. *Teledyne, Inc.*, 628 F.2d 1214, 1221 (9th Cir. 1980); *see Rochez Bros., Inc.* v. *Rhoades*, 353 F. Supp. 795, 802 (W.D. Pa. 1973), *vacated and remanded on other grounds*, 491 F.2d 402 (3d Cir. 1974); *Fisher* v. *Plessey Co.*, 559 F. Supp. 442 (S.D.N.Y. 1983).

15. *See South Coast Services Corp.* v. *Santa Ana Valley Irrigation Co.*, 669 F.2d 1265, 1272 n.4 (9th Cir. 1982) ("[T]he determination as to whether the estimates were based on sufficiently objective and reasonably certain data as to allow disclosure does not turn . . . on the other uses to which the estimates were put."); *Flynn, supra*, 744 F.2d at 989 (even reliance by the seller on speculative

(footnote continued on next page)

Third, the court of appeals dealt with a question which was not addressed by this Court in *TSC*. The undisclosed information in *TSC* was not speculative, future-oriented information, but facts involving stock holdings and stock purchases which had already occurred. (426 U.S. at 442-43). This Court's emphasis in *TSC* upon "the omitted *fact* [which] would have assumed actual significance in the deliberations of the reasonable shareholder," 426 U.S. at 449, provides a test of materiality *after* it has first been determined that the nondisclosed information is a fact. The "substantial certainty" instruction, upheld by the court of appeals, guided the jury in determining whether there was any "fact" to be disclosed, material or immaterial. It is entirely consistent with *TSC* for the court of appeals to have concluded that "soft" information must be tested against the general materiality standard only if the predictions underlying that information are "substantially certain to hold." 772 F.2d at 252-53.[16]

Regardless of whether the court of appeals' decision is viewed as a further refinement of the general materiality standard of *TSC* when speculative information is involved

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appraisals would not require disclosure to investors as material facts); *Seaboard World Airlines, Inc.* v. *Tiger International, Inc.*, 600 F.2d 355, 361-62 (2d Cir. 1979) (where stock is freely and actively traded, market price, not theoretical asset value, is the only proper basis for determining the value of a business).

16. Thus, it is wrong for petitioners to state, in their attempt to manufacture a conflict with *Flynn*, *supra*, that the court of appeals decision "means that [asset] valuations need never be disclosed." (Pet. 4). The court of appeals specifically noted that "a tender offer target must disclose projections and asset appraisals . . . only if the predictions underlying the appraisal or projection are substantially certain to hold. An example is when predictions in fact state a fixed plan of corporate activity." *Starkman* v. *Marathon Oil Co.*, *supra*, 772 F.2d at 241. It is this latter type of activity which was at issue in *SEC* v. *MacDonald*, 699 F.2d 47 (1st Cir. 1983), quoted extensively by petitioners. *MacDonald*, unlike the instant case, involved insider trading where the option of refraining from trading was readily available to the possessor of the undisclosed soft information. Moreover, the *MacDonald* court noted that "at the time of the stock purchases the lease was close enough to a sure thing as hardly to be considered a contingency at all." *Id.* at 50.

or a preliminary analysis of whether there is a "fact" to be further analyzed under the *TSC* materiality standard, it is correct and consistent with other reported decisions since *TSC* which have dealt with the same question in the same manner.[17]

17. *E.g., Bicchele* v. *Cedar Point, Inc.*, 747 F.2d 209, 216 (6th Cir. 1984) (no liability for failure to disclose "selling document" based on speculative future projections or asset valuations); *Vaughn* v. *Teledyne, Inc.*, 628 F.2d 1214 (9th Cir. 1980) (speculative asset valuations need not be disclosed); *Rodman* v. *Grant Foundation*, 608 F.2d 64 (2d Cir. 1979) ("Full factual disclosure need not be embellished with speculative financial predictions."); *James* v. *Gerber Prod. Co.*, 587 F.2d 324, 327 (6th Cir. 1978) (after an extensive discussion of *TSC*, holding: "[F]uture sales, projections, forecasts and the like, only rise to the level of materiality when they can be calculated with substantial certainty."); *Caspary* v. *Louisiana Land & Exploration Co.*, 579 F. Supp. 1105 (S.D.N.Y. 1983), *aff'd*, 725 F.2d 189 (2d Cir. 1984) (petroleum company not required to release projections of oil exploration or recovery rates); *Dower* v. *Mosser Indus., Inc.*, 488 F. Supp. 1328 (E.D. Pa. 1980), *aff'd*, 648 F.2d 183 (3d Cir. 1981) ("Neither the courts nor the SEC have ever required disclosure of such future-oriented information."); *Bradshaw* v. *Jenkins*, [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,719 (W.D. Wash. 1984) (no duty to disclose estimated value of energy loan portfolio); *Lewis* v. *Oppenheimer & Co.*, 481 F. Supp. 1199, 1208 (S.D.N.Y. 1979) ("Financial forecasts or speculations are not required by any statute, case, S.E.C. rule or regulation.").

The decision below is likewise consistent with numerous prior decisions from the Sixth Circuit and elsewhere holding that speculative projections of the future and valuations based thereon need not be disclosed. *See, e.g., Arber* v. *Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir.), *cert. denied*, 419 U.S. 830 (1974) ("[T]he law mandates disclosure only of existing material facts. It does not require an insider to volunteer any economic forecast."); *Marsh* v. *Armada Corp.*, 533 F.2d 978, 987 (6th Cir. 1976), *cert. denied*, 430 U.S. 954 (1977); *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 265 (3d Cir.), *cert. denied*, 409 U.S. 874 (1972); *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1291-44 (2d Cir. 1973); *Sunray DX Oil Co.* v. *Helmerich & Payne, Inc.*, 398 F.2d 447 (10th Cir. 1968) (disclosure of probable petroleum reserves not required); *Del Noce* v. *Delyar Corp.*, [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,670 (S.D.N.Y. 1976) (merger proxy not required to disclose estimated value of oil reserves or quantity of probable reserves); *Denison Mines Ltd.* v. *Fiberboard Corp.*, 388 F. Supp. 812, 819-21 (D. Del. 1974); *In re Brown Co. Securities Litigation*, 355 F. Supp. 574, 583-84 (S.D.N.Y. 1973).

In more basic terms, this Court should decline petitioners' invitation to establish a standard of materiality which would require the disclosure as a material fact of speculative values founded in significant part on projections of oil prices up to 50 years in the future and hypothetical revenue streams from unexplored acreage which has not yet been leased.

B. No Genuine Conflict Between the Third and Sixth Circuits Is Presented By This Case.

1. *The Prospective Test In* Flynn *Would Not Be Applied To Events Which Occurred Some Three Years Before It Was Promulgated.*

Petitioners strain to create a conflict between the decision of the Sixth Circuit below and the Third Circuit's decision in *Flynn*, but no such conflict is presented by this case. Although *Flynn* announced a multi-faceted "test" for whether "soft" information should be disclosed, which petitioners contend differs from the test applied by the Sixth Circuit below[18] (as well as by all other courts which have previously adjudicated the issue), the *Flynn* test, announced in 1984, was expressly made *prospective* in its application by the Third Circuit. Thus, even if this case were adjudicated in the Third Circuit, it would be decided under the principles of law applied by the courts below to the 1981 events underlying this case, rather than under the test subsequently announced in *Flynn*. The law in the Third Circuit was no different from that in the Sixth Cir-

18. The Sixth Circuit distinguished its decision from *Flynn* as follows (*Starkman* v. *Marathon Oil Co.*, *supra*, 772 F.2d at 241-42):

> "By its very nature, however, this sort of judicial cost-benefit analysis [in *Flynn*] is uncertain and unpredictable, and it moreover neglects the role of the market in providing shareholders with information regarding the target's value through competing tender offers. Our approach, which focuses on the certainty of the data underlying the appraisal or projection, ensures that the target company's shareholders will receive essentially factual information. . . ."

cuit at that time. *See Dower v. Mosser Industries, Inc., supra*, 488 F. Supp. 1328; *Kohn v. American Metal Climax, Inc., supra*, 458 F.2d 255.

In *Flynn*, the Third Circuit recognized the consistent reluctance of the courts to impose "potentially huge liability for nondisclosure, even if desirable as a matter of public policy," because, at the time of the alleged violation, the defendant's conduct was in accord with governing law.[19] Thus, while not foreclosing altogether the possibility that its newly-formulated rule might be applied in "other cases based on actions occurring before the date of this opinion" (744 F.2d at 988 n. 19), the panel in *Flynn* "set forth the law for disclosure of soft information as it is to be applied from this date on" and refused to apply its new test to the facts before it, which had occurred in 1976. (744 F.2d at 988). The same result would necessarily follow in this case. When the events at issue in this case occurred in 1981, the SEC and the courts were consistent in holding that "soft" information need not be disclosed. Even if *Flynn* were different from that standard, it was not decided until three years after the operative events of this case, and it would be singularly unfair to subject respondents to potential liability for conforming to what was then, and still is, the governing law but failing to anticipate the subsequent announcement by another court of a prospective, potential change in the law.

2. *The* Flynn *Test Has Not Yet Been Applied To A Real Case.*

Despite the adoption of a modified test for disclosure in *Flynn*, that test has yet to be "fleshed out" by application in decided cases. In the only cases which have cited *Flynn*, the courts have not yet applied its modified

19. *Flynn, supra*, 744 F.2d at 986, *citing South Coast Services Corp. v. Santa Ana Valley Irrigation Co.*, 669 F.2d 1265, 1271-72 (9th Cir. 1982); *Panter v. Marshall Field & Co.*, 646 F.2d 271, 292-93 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Kohn v. American Metal Climax Co., supra*, 458 F.2d at 265.

test for disclosure of "soft" information.[20] Thus, precisely how the *Flynn* test will be applied in actual cases (assuming that the panel's decision remains the law in the Third Circuit) remains to be seen. Until further development of *Flynn*, it is premature to state unequivocally that it is in conflict with the rule of law applied by the Sixth Circuit below.

When and if the *Flynn* test is applied to actual cases, its multi-factor approach (discussed *infra*) may well turn out to be merely one approach to determining which information is "substantially certain" enough to constitute a "fact" subject to disclosure. In other words, actual application of the *Flynn* test may well obviate any potential conflict between the decision below and *Flynn*.

The likelihood that conflict will be obviated by future decisions is prefigured in *Flynn* itself. The Third Circuit concluded that, even under the demonstrative application of its "new" test to the appraisals before it, the trial court had properly directed a verdict for defendants, because plaintiffs had failed to show that the information was "sufficiently reliable to be material." *Flynn*, *supra* at 290. In *Starkman*, the Sixth Circuit left open the possibility that disclosure could be required where the predictions are "substantially certain to hold." (772 F.2d at 241-42). Thus, any real difference between the opinion below and *Flynn* may turn out to be illusory.

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20. *Lockspeiser* v. *Western Maryland Co.*, 768 F.2d 558, 561 (4th Cir. 1985) (noting the *Flynn* decision in holding that nondisclosure of amounts of coal and timber reserves, as opposed to valuations thereof, presented a triable issue of fact); *Nutis* v. *Penn Merchandising Corp.*, 610 F. Supp. 1573, 1579 (E.D. Pa. 1985) (citing *Flynn* without reference to its test for soft information); *Hecco Ventures* v. *Avalon Energy Corp.*, 606 F. Supp. 512, 520 (S.D.N.Y. 1985) (noting *Flynn*, but holding, with respect to a liquidation analysis, that "this is not a case in which such speculative disclosure should be required . . .").

3. *Even If* Flynn *Were Applied In This Case, The Strong and First Boston Reports Would Not Have To Be Disclosed.*

Regardless of whether a genuine conflict between the Third and Sixth Circuits' tests for disclosure of speculative information might be presented in future cases, no such conflict is presented in this case. Taking the elements of the *Flynn* test at face value, it is clear as a matter of law that, even if *Flynn* were applied to this case, the Strong and First Boston Reports would not have been required to be disclosed in response to the U.S. Steel tender offer.[21] The factors listed in *Flynn* (744 F.2d at 988), together with a summary of the relevant evidence in this case, are:

1. "*[T]he facts upon which the information is based*" —The facts underlying the Strong and First Boston Reports were publicly reported, with the exception of the estimates of the quantity of probable and possible petroleum reserves, which could not be disclosed under applicable SEC regulations.[22] Those few underlying facts were then translated into estimated "values" by the application of optimistic future projections and assumptions. Neither the projections nor the estimated "values" which resulted were even remotely factual in nature. (Tr. 717, 729, 1493-94, 1654, 1932-33, 2111-14).

2. *[T]he qualifications of those who prepared or compiled it*"—The Strong and First Boston Reports were prepared by employees of Marathon and First Boston, respectively. While those persons had expertise in petroleum

21. As discussed *infra*, disclosure of those Reports was not required and was indeed forbidden by the regulations of the SEC in effect at the time. Thus, respondents could not have been liable for nondisclosure in reliance upon those regulations. § 23(a)(1) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78w(a)(1).

22. The quantity and hypothetical value of Marathon's proved reserves were disclosed publicly in accordance with SEC-mandated methodology. Permissible descriptions of exploratory acreage and drilling activity in pursuit of probable and possible reserves were also disclosed in Marathon's Annual Reports.

and finance, their qualifications to predict events up to 50 years in the future were not significantly different from those of any other mortal. *See Tanzer Economic Associates* v. *Haynie*, 388 F. Supp. 365, 368 (S.D.N.Y. 1974) ("Courts know what housewives and economists know—that nobody knows how to forecast safely in the current state of the economy.").

3. "*[T]he purpose for which the information was originally intended*"—Both Reports were prepared to be used as "selling documents," in an effort to obtain a higher bid if Marathon were the target of a tender offer at an inadequate price and were quickly perceived as such by potential bidders. (Tr. 676, 750-52, 885, 1626-28, 1631-33, 2109, 2143).

4. "*[I]ts relevance to the stockholders' impending decision*"—The evidence was clear that neither Report had any relevance to a shareholder's decision on whether to tender to U.S. Steel. First Boston cautioned Marathon's Board that speculative asset valuations should not be confused with the price which could actually be obtained for Marathon as a going concern or in liquidation. (Tr. 833-37, 856-66, 890-91, 1710, 1830, 1921-22, 1925). Marathon did not disclose the Reports in its efforts to defeat Mobil's tender offer. U.S. Steel gave no credence to the Reports, and they were not presented to its Board. Plaintiffs' own experts conceded that a DCF valuation of assets does not reflect the fair market value of a company's stock and that there is no clear relationship between the two. (Tr. 1031-32, 1034, 1406).

5. "*[T]he degree of subjectivity or bias reflected in its preparation*"—The Reports were prepared for use as "selling documents," and both reflect a resulting bias. As discussed above, both Reports utilized methodologies which are inherently subjective and uncertain, as evidenced by the fact that, even though they purport to measure the same company, the Reports differ by some $5 billion. (PX 102; DX 228).

6. "*[T]he degree to which the information is unique; and the availability to the investor of other more reliable*

sources of information"—The disparity between analysts' published theoretical valuations of Marathon's assets and its stock price (DX 858) confirms that the publicly-available sources of speculative information were recognized to be unreliable bases for valuing Marathon's stock. However, Marathon's public reports contained a wealth of information, including its historical earnings and even hypothetical estimated values of its assets, including proved reserves, which—unlike the Strong and First Boston Reports—had been prepared in accordance with SEC-mandated methodology. (DX 211-13; Tr. 713, 723-24, 772-74, 1083-85, 1088, 2047-75, 2157, 2163).

Thus, analysis of the factors underlying the *Flynn* test leads inductably to the conclusion that the Strong and First Boston Reports were precisely the type of "soft" information which should not have been disclosed to investors. Because of the unquestionable potential of those Reports to mislead shareholders, the Marathon respondents did not disclose them when urging shareholders to reject the Mobil offer. That same potential to mislead existed when Marathon and U.S. Steel announced their agreement, and respondents wisely and properly chose not to disclose the Reports at that time.

C. The Court Below Properly Understood SEC Rules and Policies, and Its Decision Is Entirely Consistent With Those Rules and Policies.

Petitioners' efforts to find in the Sixth Circuit's opinions in this case and *Starkman* some misinterpretation of SEC rules or policy ignores the fact that SEC rules and policy played no part in the jury verdict. While the district court heard extensive argument on SEC rules and policy, it declined to grant respondents' summary judgment or directed verdict motions on that basis, and it declined respondents' request to reference in the jury instructions the SEC rules on disclosure of oil and gas reserves. (Tr. 2291, 2384-97, 2399-402). Petitioners did not request any jury instruction on this point. Thus, even if the Sixth Circuit's sub-

sequent conclusion that the SEC rules prohibited (rather than permitted) disclosure of the First Boston and Strong Reports were erroneous, it would have no impact on the judgment which petitioners seek to reverse.

There is no conflict between the Sixth and Third Circuits with respect to SEC rules and policies covering disclosure of estimated oil and gas reserve quantities and values. The *Flynn* case did not address appraisals of oil and gas reserves and did not even mention the specific SEC rules applicable to disclosure of that information. Thus, there is no basis for the third ground for certiorari advanced in the petition.

The Sixth Circuit's reading of SEC rules and practice concerning disclosure of oil and gas reserves is plainly correct. The starting point for any discussion of SEC rules and policy concerning such information is the clear language of Regulation S-K in effect at the time of U.S. Steel's tender offer for Marathon.

> "Estimates of probable or possible reserves and any estimated value thereof shall not be disclosed in any document publicly filed with the Commission."[23]

In Securities Act Release No. 6008, the SEC adopted the prohibition and clearly articulated its underlying purpose [*Id.* at 81,104.]:

> "[S]ince in the past an occasional document has contained information concerning probable or possible reserves when originally filed, the Commission believes that an affirmative statement reflecting the present practice is appropriate. The reason the Commission does not permit disclosure of those reserves is that estimates of probable or possible reserves and any value

23. Regulation S-K, 17 C.F.R. Part 229.102, Instruction 5 to Item 102, 6 Fed. Sec. L. Rep. (CCH) ¶ 71,012. *See* SEC Securities Act Rel. No. 6008 (Dec. 19, 1978), *reprinted in* [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,768. Contrary to petitioners' assertion (Pet. 28), the First Boston Report in fact contains estimates of probable reserves (DX 228), and Regulation S-K thus applied to both the Strong and First Boston Reports.

> thereof are not sufficiently reliable to be included in any publicly filed document and disclosure of this information may be misleading to investors."

Regulation S-K's flat prohibition against disclosure of probable and possible reserves is not the result of an inadvertent failure to conform this provision to an "evolution toward more and more disclosure of so-called 'soft' information." (Pet. 24). Regulation S-K was adopted in December 1978—after the SEC had deleted future earnings from its list of examples of misleading disclosures in proxy statements and after it had proposed a safe harbor provision for "forward-looking statements, such as future earnings, made in good faith . . ." (Pet. 25).[24] The timing of the adoption of Regulation S-K thus makes clear that the SEC deliberately subjected estimates of quantity and value of oil and gas reserves to distinct and concrete rules.

The 1981 release proposing a change to Regulation S-K[25] (No. 6332) (Pet. 25-26) is not to the contrary. That proposed rule change had not been adopted at the time of U.S. Steel's tender offer and, indeed, has *never* been adopted. In Securities Act Rel. No. 6383 (March 3, 1982),[26] the SEC explained:

> "Instruction 5 to Item 102 was proposed to be revised to permit disclosure of less than proved or probable reserves in certain cases where the staff of the Commission could be shown that such disclosure was required by foreign law or was necessary to prevent the disclosure from being misleading. The conditions

24. *See* SEC Securities Act Rel. No. 5699 (April 23, 1976), *reprinted in* [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,461; SEC Securities Act Rel. No. 5993 (Nov. 7, 1978), *reprinted in* [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,757.

25. SEC Securities Act Rel. No. 6332 (Aug. 12, 1981), *reprinted in* [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,016.

26. SEC Securities Act Rel. No. 6383 (March 3, 1982), *reprinted in* [1937-82 Accounting Series Rel. Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,328 at 63,003.

> proposed as the basis for inclusion of such information were the subject of commentator criticism. As a result, Instruction 5 has been revised to permit disclosure of less than proved oil and gas reserves, or proved or probable reserves in other cases, where such information is required by foreign or state law to be disclosed in the document. The Instruction now also permits such reserve data to be disclosed where it has been provided previously to a person (or any of its affiliates) that is engaged in an acquisition of the registrant or its equity securities."

The final revisions adopted in 1982, consequently, reject the proposal that other than proved reserves be disclosed if it is shown to the SEC staff that failure to disclose such reserves would render the document materially misleading. Whatever the source of the dictum on SEC staff practice in Release No. 6332 (quoted at Pet. 26), it is clear that the proposal represented a substantial change which elicited criticism from commentators and which, upon reflection, the SEC concluded should not be adopted.[27]

The change which the SEC did adopt in 1982 (after the U.S. Steel tender offer)—to permit (but not require)[28]

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27. The letter of Mr. Charles Schwartz, then secretary of U.S. Steel, in support of the proposed rule change (Appendix, p. 23A) does not assist petitioners. Petitioners' effort to convert U.S. Steel's support for a proposed rule change into acquiescence with a nonexistent SEC practice is belied by the letter itself. The focus of Mr. Schwartz's letter was on mineral reserves, other than oil and gas, for which a different set of SEC rules applied. In concluding the paragraph on reserve data, after having supported the rule change generally (while at the same time acknowledging that current rules prohibited such disclosure), Mr. Schwartz clearly indicated that a different standard for disclosure of oil and gas reserves might continue to be appropriate: "Finally, we suggest that the Commission consider that other circumstances still warrant treating oil and gas reserves differently from the other reserves." (Appendix, p. 27A).

28. The fact that the Sixth Circuit properly recognized that disclosure is only permitted under the new 1982 rule (Pet. 27-28) hardly aids petitioners' argument. The fundamental point, recognized by the court of appeals, is that such disclosure was prohibited at the time of U.S. Steel's tender offer in 1981.

disclosure of reserve data when it had previously been provided to a person engaged in an acquisition of the registrant—refutes petitioners' position. The need for an amendment in order to allow such disclosure underscores the fact that the SEC forbade it at the time U.S. Steel made its tender offer in 1981.

SEC Staff Accounting Bulletin No. 47, Topic 12, Section 3(b) ("Staff Accounting Bulletin"),[29] of which petitioners quote only a fragment (Pet. 27), also makes clear that the SEC prohibited disclosure of values of probable and possible oil and gas reserves at the time of U.S. Steel's offer. The entire bulletin, including its assumed facts, which were omitted from the petition, makes clear that the SEC indicated only that values of undeveloped leasehold *acreage*, based on comparable sales of similar acreage and related factors—not petroleum *reserves valued using a DCF methodology*—could be disclosed, which, of course, is not an issue in this case.[30]

The rules that applied to disclosure of proved oil and gas reserves at the time of U.S. Steel's tender offer further undercut petitioners' position. The rules permitted disclosure of estimates of quantities of proved reserves, and required in the notes to financial statements an estimate of the present value of future net cash flow from those reserves calculated in a manner far different from the methods used in the Strong and First Boston Reports. The rule governing those disclosures—contained in Regulation S-X[31]—prescribed a uniform method to be used in reporting those numbers, mandating, for example, that no significant assumptions were to be disclosed or used except as specifically provided in the Regulation. SEC Account-

29. Staff Accounting Bulletin 47 (Sept. 16, 1982), *reprinted in* 6 Fed. Sec. L. Rep. (CCH) ¶ 74,211 at 63,944.

30. *Id.* All of the relevant portion of the Bulletin is reproduced in the Appendix at p. 34A.

31. 17 C.F.R. § 210.4-10(k)(5)-(6). Marathon, of course, had made the disclosures required by Regulation S-X in its Annual Reports. (Pet. 26 n.12).

ing Series Release No. 253 (Aug. 31, 1978), *reprinted in* [1937-82 Accounting Series Rel. Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,275.[32]

Finally, SEC Rule 13e-3, 17 C.F.R. § 240.13e-3, does not change the basic SEC prohibition against disclosure of probable or possible oil and gas reserves. That rule (which does not mention oil and gas reserves) requires disclosure of certain "outside" asset appraisals, but only in the context of a "Rule 13e-3 transaction".[33] The Sixth Circuit held that U.S. Steel's tender offer was not a "Rule 13e-3 transaction," and petitioners do not seek review of that decision. 772 F.2d at 253-55.

There is neither a conflict between circuits nor a judicial disregard of applicable SEC rules. Petitioners' third ground for their petition is, therefore, without merit.

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32. The SEC implicitly recognized that even estimates of the quantity and future net cash flow of proved reserves disclosed in the carefully circumscribed fashion required by Regulation S-X may turn out to be misleading by providing a safe harbor provision for those who comply with the Regulation. SEC Accounting Series Release No. 257 (Dec. 19, 1978), *reprinted in* [1937-82 Accounting Series Rel. Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,279 at 62,749-47.

33. Rule 13e-3 applies to so-called "going private" transactions by an issuer with itself or an affiliate. As the SEC releases make clear and as the Sixth Circuit noted below (772 F.2d at 253-55), the SEC has concluded that there should be more detailed disclosure in such transactions than would normally be required for a transaction negotiated at arm's-length. SEC Exchange Act Rel. No. 16075 (Aug. 2, 1979), [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,166. *See also* SEC Exchange Act Rel. No. 11231 (Feb. 6, 1975), [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,104. Although the U.S. Steel/Marathon negotiations were conducted at arms-length, the merger, but not the tender offer, was nonetheless technically subject to Rule 13e-3. Accordingly, the First Boston Report was disclosed in the Proxy Statement as an "outside appraisal" under Rule 13e-3, and, under those circumstances, the Strong Report was disclosed as well.

IV.

Conclusion

For the foregoing reasons, the Petition for a Writ of Certiorari to the Court of Appeals for the Sixth Circuit should be denied.

Respectfully submitted,

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Dated: January 15, 1986

APPENDIX

§ 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

§ 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(e)

Untrue statement of material fact or omission of fact with respect to tender offer

(e) It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

§ 23(a)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78w(a)(1)

Rules, regulations, and orders; annual reports

(a) Power to make rules and regulations; considerations; public disclosure

(1) The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 78c(a)(34) of this title shall each have power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter for which they are responsible or for the execution of the functions vested in them by this chapter, and may for such purposes classify persons, securities, transactions, statements, applications, reports, and other matters within their respective jurisdictions, and prescribe greater, lesser, or different requirements for different classes thereof. No provision of this chapter imposing any liability shall apply to any act done or omitted in good faith in conformity with a rule, regulation, or order of the Commission, the Board of Governors of the Federal Reserve System, other agency enumerated in section 78c(a)(34) of this title, any self-regulatory organization, notwithstanding that such rule, regulation, or order may thereafter be amended or rescinded or determined by judicial or other authority to be invalid for any reason.

SEC Rule 13e-3, 17 C.F.R. § 240.13e-3

Going private transactions by certain issuers or their affiliates.

(a) *Definitions.* Unless indicated otherwise or the context otherwise requires, all terms used in this section and in Schedule 13E-3 [§ 240.13e-100] shall have the same meaning as in the Act or elsewhere in the General Rules and

Regulations thereunder. In addition, the following definitions apply:

(1) An "affiliate" of an issuer is a person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with such issuer. For the purposes of this section only, a person who is not an affiliate of an issuer at the commencement of such person's tender offer for a class of equity securities of such issuer will not be deemed an affiliate of such issuer prior to the stated termination of such tender offer and any extensions thereof:

(2) The term "purchase" means any acquisition for value including, but not limited to, (i) any acquisition pursuant to the dissolution of an issuer subsequent to the sale or other disposition of substantially all the assets of such issuer to its affiliate, (ii) any acquisition pursuant to a merger, (iii) any acquisition of fractional interests in connection with a reverse stock split, and (iv) any acquisition subject to the control of an issuer or an affiliate of such issuer;

(3) A "Rule 13e-3 transaction" is any transaction or series of transactions involving one or more of the transactions described in paragraph (a)(3)(i) of this section which has either a reasonable likelihood or a purpose of producing, either directly or indirectly, any of the effects described in paragraph (a)(3)(ii) of this section;

(i) The transactions referred to in paragraph (a)(3) of this section are:

(A) A purchase of any equity security by the issuer of such security or by an affiliate of such issuer;

(B) A tender offer for or request or invitation for tenders of any equity security made by the issuer of such class of securities or by an affiliate of such issuer; or

(C) A solicitation subject to Regulation 14A [§§ 240.14a-1 to 240.14a-103] of any proxy, consent or authorization

of, or a distribution subject to Regulation 14C [§§ 240.14c-1 to 14c-101] of information statements to, any equity security holder by the issuer of the class of securities or by an affiliate of such issuer, in connection with: a merger, consolidation, reclassification, recapitalization, reogranization or similar corporate transaction of an issuer or between an issuer (or its subsidiaries) and its affiliate; a sale of substantially all the assets of an issuer to its affiliate or group of affiliates; or a reverse stock split of any class of equity securities of the issuer involving the purchase of fractional interests.

(ii) The effects referred to in paragraph (a)(3) of this section are:

(A) Causing any class of equity securities of the issuer which is subject to section 12(g) or section 15(d) of the Act to be held of record by less than 300 persons; or

(B) Causing any class of equity securities of the issuer which is either listed on a national securities exchange or authorized to be quoted in an inter-dealer quotation system of a registered national securities association to be neither listed on any national securities exchange nor authorized to be quoted on an inter-dealer quotation system of any registered national securities association.

(4) An "unaffiliated security holder" is any security holder of an equity security subject to a Rule 13e-3 transaction who is not an affiliate of the issuer of such security.

(b) *Application of section to an issuer (or an affiliate of such issuer) subject to section 12 of the Act.* (1) It shall be a fraudulent, deceptive or manipulative act or practice, in connection with a Rule 13e-3 transaction, for an issuer which has a class of equity securities registered pursuant to section 12 of the Act or which is a closed-end investment company registered under the Investment Company Act of 1940, or an affiliate of such issuer, directly or indirectly

(i) To employ any device, scheme or artifice to defraud any person;

(ii) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(iii) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

(2) As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices in connection with any Rule 13e-3 transaction, it shall be unlawful for an issuer which has a class of equity securities registered pursuant to section 12 of the Act, or an affiliate of such issuer, to engage, directly or indirectly, in a Rule 13e-3 transaction unless:

(i) Such issuer or affiliate complies with the requirements of paragraphs (d), (e) and (f) of this section; and

(ii) The Rule 13e-3 transaction is not in violation of paragraph (b)(1) of this section.

(c) *Application of section to an issuer (or an affiliate of such issuer) subject to section 15(d) of the Act.* (1) It shall be unlawful as a fraudulent, deceptive or manipulative act or practice for an issuer which is required to file periodic reports pursuant to Section 15(d) of the Act, or an affiliate of such issuer, to engage, directly or indirectly, in a Rule 13e-3 transaction unless such issuer or affiliate complies with the requirements of paragraphs (d), (e) and (f) of this section.

(2) An issuer or affiliate which is subject to paragraph (c)(1) of this section and which is soliciting proxies or distributing information statements in connection with a transaction described in paragraph (a)(3)(i)(A) of this section may elect to use the timing procedures for con-

ducting a solicitation subject to Regulation 14A (§§ 240.14a-1 to 240.14a-103) or a distribution subject to Regulation 14C (§§ 240.14c-1 to 240.14c-101) in complying with paragraphs (d), (e) and (f) of this section, provided that if an election is made, such solicitation or distribution is conducted in accordance with the requirements of the respective regulations, including the filing of preliminary copies of soliciting materials or an information statement at the time specified in Regulation 14A or 14C, respectively.

(d) *Material required to be filed.* The issuer or affiliate engaging in a Rule 13e-3 transaction shall, in accordance with the General Instructions to the Rule 13e-3 Transaction Statement on Schedule 13E-3 [§ 240.13e-100]:

(1) File with the Commission eight copies of such schedule, including all exhibits thereto;

(2) Report any material change in the information set forth in such schedule by promptly filing with the Commission eight copies of an amendment on such schedule; and

(3) Report the results of the Rule 13e-3 transaction by filing with the Commission promptly but no later than ten days (ten business days if Rule 13e-4 [§ 240.13e-4] is applicable, after the termination of such transaction eight copies of a final amendment to such schedule.

(e) *Disclosure of certain information.* (1) The issuer or affiliate engaging in the Rule 13e-3 transaction, in addition to any other information required to be disclosed pursuant to any other applicable rule or regulation under the federal securities laws, shall disclose to security holders of the class of equity securities which is the subject of the transaction, in the manner prescribed by paragraph (f) of this section, the information required by Items 1, 2, 3, 4, 5, 6, 10, 11, 12, 13, 14, 15 and 16 of Schedule 13e-3 [§ 240.13e-100], or a fair and adequate summary thereof, and Items 7, 8 and 9 and include in the document which

contains such information the exhibit required by Item 17(e) of such Schedule. If the Rule 13e-3 transaction involves (i) a transaction subject to Regulation 14A [§§ 240.14a-1 to 240.14a-103] or 14C [§§ 240.14c-1 to 240.14c-101] of the Act, (ii) the registration of securities pursuant to the Securities Act of 1933 and the General Rules and Regulations promulgated thereunder, or (iii) a tender offer subject to Regulation 14D [§§ 240.14d-1 to 240.14d-101] or Rule 13e-4 [§ 240.13e-4], such information shall be included in the proxy statement, the information statement, the registration statement or the tender offer for or request or invitation for tenders of securities published, sent or given to security holders, respectively.

(2) If any material change occurs in the information previously disclosed to security holders of the class of equity securities which is the subject of the transaction, the issuer or affiliate shall promptly disclose such change to such security holders in the manner prescribed by paragraph (f)(1)(iii) of this section.

(3) Any document transmitted to such security holders which contains the information required by paragraph (e)(1) of this section shall:

(i) Set forth prominently the information required by Items 7, 8 and 9 of the Rule 13e-3 Transaction Statement on Schedule 13E-3 [§ 240.13e-100] in a Special Factors section to be included in the forepart of such document; and

(ii) Set forth on the outside front cover page, in capital letters printed in bold face roman type at least as large as ten point modern type and at least two points leaded, the statement in paragraph (e)(3)(ii)(A) of this section, if the Rule 13e-3 transaction does not involve a prospectus, or the statement in paragraph (e)(3)(ii)(B) of this section, if the Rule 13e-3 transaction involves a prospectus, and in the latter case such statement shall be used in lieu of that

required by Item 501(c)(5) of Regulation S-K (§ 229.501 of this chapter).

(A) THIS TRANSACTION HAS NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE FAIRNESS OR MERITS OF SUCH TRANSACTION NOR UPON THE ACCURACY OF ADEQUACY OF THE INFORMATION CONTAINED IN THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS UNLAWFUL.

(B) NEITHER THIS TRANSACTION NOR THESE SECURITIES HAVE BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION. THE COMMISSION HAS NOT PASSED UPON THE FAIRNESS OR MERITS OF THIS TRANSACTION NOR UPON THE ACCURACY OR ADEQUACY OF THE INFORMATION CONTAINED IN THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS UNLAWFUL.

Instructions. 1. Negative responses to any item of Schedule 13E-3 [§ 240.13e-100] need not be included in the information disseminated to security holders unless otherwise indicated.

2. Although the financial information necessary to present a fair and adequate summary of Item 14 of Schedule 13E-3 [§ 240.13e-100] may vary depending on the facts and circumstances involved, the following historical and pro forma summary financial information normally will be sufficient for purposes of paragraph (e) of this section:

(a) The following summary financial information for (i) the two most recent fiscal years and (ii) the latest year-to-date interim period and corresponding interim period of the preceding year:

Income Statement:

Net sales and operating revenues and other revenues
Income before extraordinary items
Net Income
Balance Sheet (at end of period):

Working capital
Total assets
Total assets less deferred research and development charges and excess of cost of assets acquired over book value.
Shareholder's equity
Per Share:[1]
Income per common share before extraordinary items
Extraordinary items
Net income per common share (and common share equivalents, if applicable)
Net income per share on a fully diluted basis

(b) Ratio of earnings to fixed charges for the same periods required by 2(a) above:

(c) Book value per share as the most recent fiscal year end and as of the date of the latest interim balance sheet; and

(d) If material, pro forma data for the summarized financial information described in 2(a), (b), and (c) above, disclosing the effect of the transaction, should be provided for the most recent fiscal year and latest year-to-date interim period.

If the information required by Item 14 is summarized, appropriate instructions should be included stating how more complete financial information can be obtained.

(f) *Dissemination of disclosure.* (1) If the Rule 13e-3 transaction involves a purchase as described in paragraph (a)(3)(i)(A) of this section or a vote, consent, authorization, or distribution of information statements as described in paragraph (a)(3)(i)(C) of this section, the insurer or affiliate engaging in the Rule 13e-3 transaction shall:

(i) Provide the information required by paragraph (e) of this section: (A) In accordance with the provisions of

1. Average number of shares of common stock outstanding during each period was———(as adjusted to give effect to stock dividends or stock splits).

any applicable Federal or State law, but in no event later than 20 days prior to: any such purchase; any such vote, consent or authorization; or with respect to the distribution of information statements, the meeting date, or if corporate action is to be taken by means of the written authorization or consent of security holders, the earliest date on which corporate action may be taken: *Provided, however,* That if the purchase subject to this section is pursuant to a tender offer excepted from Rule 13e-4 by paragraph (g)(5) of Rule 13e-4, the information required by paragraph (e) of this section shall be disseminated in accordance with paragraph (e) of Rule 13e-4 no later than 10 business days prior to any purchase pursuant to such tender offer, (B) to each person who is a record holder of a class of equity securities subject to the Rule 13e-3 transaction as of a date not more than 20 days prior to the date of dissemination of such information.

(ii) If the issuer or affiliate knows that securities of the class of securities subject to the Rule 13e-3 transaction are held of record by a broker, dealer, bank or voting trustee or their nominees, such issuer or affiliate shall (unless Rule 14a-3(d) [§ 240.14a-3(d)] or 14c-7 [§ 240.14c-7] is applicable) furnish the number of copies of the information required by paragraph (e) of this section that are requested by such persons (pursuant to inquiries by or on behalf of the issuer or affiliate), instruct such persons to forward such information to the beneficial owners of such securities in a timely manner and undertake to pay the reasonable expenses incurred by such persons in forwarding such information; and

(iii) Promptly disseminate disclosure of material changes to the information required by paragraph (d) of this section in a manner reasonably calculated to inform security holders.

(2) If the Rule 13e-3 transaction is a tender offer or a request or invitation for tenders of equity securities which

is subject to Regulation 14D [§§ 240.14d-1 to 240.14d-101] or Rule 13e-4 [§ 240.13e-4], the tender offer containing the information required by paragraph (e) of this section, and any material change with respect thereto, shall be published, sent or given in accordance with Regulation 14D or Rule 13e-4, respectively, to security holders of the class of securities being sought by the issuer or affiliate.

(g) *Exceptions.* This section shall not apply to:

(1) Any Rule 13e-3 transaction by or on behalf of a person which occurs within one year of the date of termination of a tender offer in which such person was the bidder and became an affiliate of the issuer as a result of such tender offer: *Provided,* That the consideration offered to unaffiliated security holders in such Rule 13e-3 transaction is at least equal to the highest consideration offered during such tender offer and *Provided further,* That:

(i) If such tender offer was made for any or all securities of a class of the issuer;

(A) Such tender offer fully disclosed such person's intention to engage in a Rule 13e-3 transaction, the form and effect of such transaction and, to the extent known, the proposed terms thereof; and

(B) Such Rule 13e-3 transaction is substantially similar to that described in such tender offer; or

(ii) If such tender offer was made for less than all the securities of a class of the issuer:

(A) Such tender offer fully disclosed a plan of merger, a plan of liquidation or a similar binding agreement between such person and the issuer with respect to a Rule 13e-3 transaction; and

(B) Such Rule 13e-3 transaction occurs pursuant to the plan of merger, plan of liquidation or similar binding agreement disclosed in the bidder's tender offer.

(2) Any Rule 13e-3 transaction in which the security holders are offered or receive only an equity security *Provided*, That:

(i) Such equity security has substantially the same rights as the equity security which is the subject of the Rule 13e-3 transaction including, but not limited to, voting, dividends, redemption and liquidation rights except that this requirement shall be deemed to be satisfied if unaffiliated security holders are offered common stock;

(ii) Such equity security is registered pursuant to section 12 of the Act or reports are required to be filed by the issuer thereof pursuant to section 15(d) of the Act; and

(iii) If the security which is the subject of the Rule 13e-3 transaction was either listed on a national securities exchange or authorized to be quoted in an interdealer quotation system of a registered national securities association, such equity security is either listed on a national securities exchange or authorized to be quoted in an interdealer quotation system of a registered national securities association.

(3) Transactions by a holding company registered under the Public Utility Holding Company Act of 1935 in compliance with the provisions of that Act;

(4) Redemptions, calls or similar purchases of an equity security by an issuer pursuant to specific provisions set forth in the instrument(s) creating or governing that class of equity securities; or

(5) Any solicitation by an issuer with respect to a plan of reorganization under Chapter X of the Bankruptcy Act, as amended, if made after the entry of an order approving such plan pursuant to section 174 of that Act and after, or concurrently with, the transmittal or information concerning such plan as required by section 175 of the Act.

SEC Rule 14d-9, 17 C.F.R. § 240.14d-9

Solicitation/recommendation statements with respect to certain tender offers.

(a) *Filing and transmittal of recommendation statement.* No solicitation or recommendation to security holders shall be made by any person described in paragraph (d) of this section with respect to a tender offer for such securities unless as soon as practicable on the date such solicitation or recommedation is first published or sent or given to security holders such person complies with the following subparagraphs:

(1) Such person shall file with the Commission eight copies of a Tender Offer Solicitation/Recommendation Statement on Schedule 14D-9 (§ 240.14d-101), including all exhibits thereto; and

(2) If such person is either the subject company or an affiliate of the subject company,

(i) Such person shall hand deliver a copy of the Schedule 14D-9 to the bidder at its principal office or at the address of the person authorized to receive notices and communications (which is set forth on the cover sheet of the bidder's Schedule 14D-1 (§ 240.14d-100) filed with the Commission; and

(ii) Such person shall give telephonic notice (which notice to the extent possible shall be given prior to the opening of the market) of the information required by Items 2 and 4(a) of Schedule 14D-9 and shall mail a copy of the Schedule to each national securities exchange where the class of securities is registered and listed for trading and, if the class is authorized for quotation in the NASDAQ interdealer quotation system, to the National Association of Securities Dealers, Inc. ("NASD").

(3) If such person is neither the subject company nor an affiliate of the subject company,

(i) Such person shall mail a copy of the schedule to the bidder at its principal office or at the address of the person authorized to receive notices and communications (which is set forth on the cover sheet of the bidder's Schedule 14D-1 (§ 240.14d-100) filed with the Commission); and

(ii) Such person shall mail a copy of the Schedule to the subject company at its principal office.

(b) *Amendments.* If any material change occurs in the information set forth in the Schedule 14D-9 (§ 240.14d-101) required by this section, the person who filed such Schedule 14D-9 shall:

(1) File with the Commission eight copies of an amendment on Schedule 14D-9 (§ 240.14d-101) disclosing such change promptly, but not later than the date such material is first published, sent or given to security holders; and

(2) Promptly deliver copies and give notice of the amendment in the same manner as that specified in paragraph (a)(2) or paragraph (a)(3) of this section, whichever is applicable; and

(3) Promptly disclose and disseminate such change in a manner reasonably designed to inform security holders of such change.

(c) *Information required in solicitation or recommendation.* Any solicitation or recommendation to holders of a class of securities referred to in section 14(d)(1) of the Act with respect to a tender offer for such securities shall include the name of the person making such solicitation or recommendation and the information required by Items 1, 2, 3(b), 4, 6, 7 and 8 of Schedule 14D-9 (§ 240.14d-101) or a fair and adequate summary thereof: *Provided, however,* That such solicitation or recommendation may omit any of such information previously furnished to security holders of such class of securities by such person with respect to such tender offer.

(d) *Applicability.* (1) Except as is provided in paragraphs (d)(2) and (e) of this section shall only apply to the following persons:

(i) The subject company, any director, officer, employee, affiliate or subsidiary of the subject company;

(ii) Any record holder or beneficial owner of any security issued by the subject company, by the bidder, or by any affiliate of either the subject company or the bidder; and

(iii) Any person who makes a solicitation or recommendation to security holders on behalf of any of the foregoing or on behalf of the bidder other than by means of a solicitation or recommendation to security holders which has been filed with the Commission pursuant to this section or Rule 14d-3 (§ 240.14d-3).

(2) Notwithstanding paragraph (d)(1) of this section, this section shall not apply to the following persons:

(i) A bidder who has filed a Schedule 14D-1 (§ 240.14d-101) pursuant to Rule 14d-3 (§ 240.14d-3);

(ii) Attorneys, banks, brokers, fiduciaries or investment advisers who are not participating in a tender offer in more than a ministerial capacity and who furnish information and/or advice regarding such tender offer to their customers or clients on the unsolicited request of such customers or clients or solely pursuant to a contract or a relationship providing for advice to the customer or client to whom the information and/or advice is given.

(e) *Stop-look-and-listen communication.* This section shall not apply to the subject company with respect to a communication by the subject company to its security holders which only:

(1) Identifies the tender offer by the bidder;

(2) States that such tender offer is under consideration by the subject company's board of directors and/or management;

(3) States that on or before a specified date (which shall be no later than 10 business days from the date of commencement of such tender offer) the subject company will advise such security holders of (i) whether the subject company recommends acceptance or rejection of such tender offer; expresses no opinion and remains neutral toward such tender offer; or is unable to take a position with respect to such tender offer and (ii) the reason(s) for the position taken by the subject company with respect to the tender offer (including the inability to take a position); and

(4) Requests such security holders to defer making a determination whether to accept or reject such tender offer until they have been advised of the subject company's position with respect thereto pursuant to paragraph (e)(3) of this section.

(f) *Statement of management's position.* A statement by the subject company's of its position with respect to a tender offer which is required to be published or sent or given to security holders pursuant to Rule 14e-2 shall be deemed to constitute a solicitation or recommendation within the meaning of this section and section 14(d)(4) of the Act.

SEC Regulation S-K, Item 102, 17 C.F.R., Part 229.102
Description of Property

State briefly the location and general character of the principal plants, mines and other materially important physical properties of the registrant and its subsidiaries. In addition, identify the industry segment(s) that use the properties described. If any such property is not held in fee or is held subject to any major encumbrance, so state and describe briefly how held.

Instructions to Item 102. 1. What is required is such information as reasonably will inform investors as to the suitability, adequacy, productive capacity and extent of utilization of the facilities by the registrant. Detailed descriptions of the physical characteristics of individual properties or legal descriptions by metes and bounds are not required and shall not be given.

2. In determining whether properties should be described, the registrant should take into account both quantitative and qualitative factors. See Instruction 1 to Item 101 of Regulation S-K (§ 229.101).

3. In the case of an extractive enterprise, material information shall be given as to production, reserves, locations, development and the nature of the registrant's interest. If individual properties are of major significance to an industry segment:

A. More detailed information concerning these matters shall be furnished; and

B. Appropriate maps shall be used to disclose location data of significant properties except in cases for which numerous maps would be required.

4. A. If reserve estimates are referred to in the document, the staff of the Office of Engineering, Division of Corporation Finance of the Commission, shall be consulted. That Office may request that a copy of the full report of the engineer or other expert who estimated the reserves be furnished as supplemental information and not as part of the filing. See Rule 418 of Regulation C (§ 230.418 of this chapter) and Rule 12b-4 of Regulation 12B (§ 240.12b-4 of this chapter) with respect to the submission to, and return by, the Commission of supplemental information.

B. If the estimates of reserves, or any estimated valuation thereof, are represented as being based on

estimates prepared or reviewed by independent consultants, those independent consultants shall be named in the document.

5. Estimates of oil or gas reserves other than proved or, in the case of other extractive reserves, estimates other than proved or probable reserves, and any estimated values of such reserves shall not be disclosed in any document publicly filed with the Commission, unless such information is required to be disclosed in the document by foreign or state law; provided, however, that where such estimates previously have been provided to a person (or any of its affiliates) that is offering to acquire, merge or consolidate with the registrant or otherwise to acquire the registrant's securities, such estimates may be included in documents relating to such acquisition.

6. The definitions in § 210.4-10(a) of Regulation S-X [17 CFR 210] shall apply to this Item with respect to oil and gas operations.

SEC Reg. S-X, 17 C.F.R. § 210.4-10(k)(5)-(6)

(5) *Disclosure of estimated quantities of proved oil and gas reserves.* Net quantities of proved reserves and proved developed reserves of crude oil (including condensate and natural gas liquids) and natural gas shall be reported as of the beginning and the end of each fiscal year for which an income statement is required. "Net" quantities of reserves include those relating to the operating and non-operating interests in properties as defined in paragraph (b)(1) of this section. Quantites of reserves relating to royalty interests owned shall be included in "net" quantities if the necessary information is available; if reserves relating to royalty interests owned are not included because the information is unavailable, that fact and the reporting entity's share of oil and gas produced for those royalty interests shall be reported for each year

for which a complete set of financial statements is presented. "Net" quantities shall not include reserves relating to interests of others in properties owned by the reporting entity.

(i) Changes in the net quantities of proved reserves of oil and of gas during each fiscal year for which an income statement is required shall be reported. Changes resulting from each of the following shall be shown separately, with appropriate explanation of significant changes:

(A) *Revisions of previous estimates.* Revisions represent changes in previous estimates of proved reserves, either upward or downward, resulting from new information (except for an increase in proved acreage) normally obtained from development drilling and production history or resulting from a change in economic factors.

(B) *Improved recovery.* Changes in reserve estimates resulting from application of improved recovery techniques shall be separately shown if significant. If not significant, such changes shall be included in revisions of previous estimates.

(C) *Purchases of minerals-in-place.*

(D) *Extensions, discoveries, and other additions.* Additions to proved reserves that result from extension of the proved acreage of previously discovered (old) reservoirs through additional drilling in periods subsequent to discovery and discovery of new fields with proved reserves or of new reservoirs of proved reserves in old fields.

(E) *Production.*

(F) *Sales of minerals in-place.*

(ii) If the reporting entity's proved reserves of oil and gas are located entirely within its home country, that fact shall be disclosed. If some or all of its reserves are located in foreign countries, the disclosures of net quantities

of reserves of oil and gas and changes in them (as required above) shall be separately reported for the entity's home country (if significant reserves are located there) and each foreign geographic area in which significant reserves are located. Foreign geographic areas are individual countries or groups of countries, as appropriate, for meaningful disclosure in the circumstances.

(iii) Net quantities disclosed shall not include oil or gas subject to purchase under long-term supply, purchase, or similar agreements and contracts, including such agreements with foreign governments or authorities. However, quantities of oil and gas subject to such agreements with foreign goverments or authorities as of the end of each fiscal year for which an income statement is required, and the net quantity of oil or gas received under the agreements during each such year, shall be separately disclosed if the reporting entity participates in the operation of the properties in which the oil or gas is located or otherwise serves as the "producer" of those reserves, as opposed, for example, to being an independent purchaser, broker, dealer, or importer.

(iv) In determining the reserve quantities to be reported:

(A) If consolidated financial statements are issued, 100 percent of the net reserve quantities attributable to the parent company and 100 percent of the net reserve quantities attributable to its consolidated subsidiaries (whether or not wholly owned) shall be included.

(B) If the financial statements include investments that are proportionately consolidated, reserve quantities shall include a proportionate share of the investee's net oil and gas reserves.

(C) If the financial statements include investments that are accounted for by the equity method, the investee's net

proved oil and gas reserves shall not be included in the disclosures of reserves. However, the reporting entity's share of the investee's net proved oil and gas reserves shall be separately reported as of the end of each fiscal year for which an income statement is required.

(v) If important economic factors or significant uncertainties affect particular components of proved reserves, explanations shall be provided. Examples include unusually high expected development or lifting costs; the necessity to build a major pipeline or other major facilities before production of the reserves can begin; or contractual obligations to produce and sell a significant portion of reserves at prices that are substantially below those at which the oil and gas could otherwise be sold in the absence of the contractual obligation.

(vi) In reporting reserve quantities and changes in them, oil reserves (which include condensate and natural gas liquids) shall be stated in barrels, and gas reserves in cubic feet.

(vii) If any foreign government restricts the disclosure of estimated reserves for properties under its governmental authority, or amounts under long-term supply, purchase, or similar agreements, or if the foreign government requires the disclosure of reserves other than proved, the registrant should identify the country, cite the law or regulation which restricts or requires such disclosure, and indicate that the reported reserve estimates or amounts do not include figures for the named country or that reserve estimates include reserves other than proved.

(6) *Disclosure of future net revenues from estimated production of proved oil and gas reserves.* In conjunction with the disclosure of changes in net quantities of estimated proved reserves of crude oil (including condensate and natural gas liquids) and natural gas as required by paragraph (k)(5) of this section, the following information

shall be disclosed in financial statements for each geographic classification for which quantities of oil and gas are disclosed:

(i) For each of the following categories: (A) Proved oil and gas reserves, (B) proved developed oil and gas reserves, (C) proved oil and gas applicable to long-term supply or similar agreements with foreign governments in which the entity acts as producer, and (D) the entity's share of proved oil and gas reserves of investees accounted for by the equity method, an amount (the "Estimated Future Net Revenues"), in the aggregate, computed by applying current prices of oil and gas (with consideration of price changes only to the extent provided by contractual arrangements) to estimated future production of proved oil and gas reserves as of the date of the latest balance sheet presented, less estimated future expenditures (based on current costs) to be incurred in developing and producing the proved reserves, and assuming continuation of existing economic conditions. Present separately the amounts applicable to each of the first three succeeding fiscal years, and the remainder in a single amount. Indicate the basis used to compute current prices and current costs.

(ii) The present value of the Estimated Future Net Revenues (the "Present Value of Estimated Future Net Revenues"), as of the end of each fiscal year for which an income statement is required, computed using a discount factor of ten percent, for each of the categories for which Estimated Future Net Revenues are disclosed pursuant to paragraph (k)(6)(i) of this section.

(iii) Any additional information of which management is aware and which it believes is necessary to prevent the above information from being misleading.

United States Steel Corporation Letter to SEC

October 30, 1981

Mr. George A. Fitzsimmons
Secretary
Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549

Re: Files S7-893
S7-894
S7-896

Dear Mr. Secretary:

United States Steel Corporation respectfully submits the following comments regarding the Commission's Integrated Disclosure Program as proposed in the Commission's releases dated August 6, 1981. We support the concept of integration of disclosure requirements under the several federal securities statutes, and in general we favor the proposals contained in the releases. Set forth below are our specific comments on each of the releases, which follow the chronological order of the Securities Act Release Numbers assigned by the Commission to each proposal.

Release Number 33-6331

In general we support the concept of allowing most registrants to fulfill their disclosure obligations under the Securities Act by incorporating their disclosures under the Exchange Act. Since the periodic reports under the Exchange Act are the single most important source of market information concerning publicly traded corporations upon which the market trades previously issued securities of a corporation, this information should form the basis for disclosure concerning newly issued securities.

We have the following comments concerning proposed Form S-3, which would be the primary registration statement form used by widely followed corporations, such as U. S. Steel. We suggest that the requirement that there be $150 million in aggregate market value of common stock held by non-affiliates in the context of continuous offerings be keyed to a specific date, such as the end of the last fiscal year. In the context of a continuous offering, such as a dividend reinvestment plan, the issuer should be allowed to combine its inquiry of its officers and directors concerning their holdings of its securities made for proxy statement purposes with that which it must make for determining holdings for qualification to use of the form as well. There are also three specific items of the form which concern us. Item 2, which requires disclosure of what documents are incorporated by reference and how the reader may obtain them, seems misplaced on the inside cover. We suggest that it be included in the body of the prospectus, perhaps after Item 9. Item 2 is essentially Item 6(b) of present Form S-16, and we feel that it appropriately belongs in the body of the prospectus as it is placed in the current S-16. We also question the appropriateness of Item 9, description of securities to be registered, in registration statements covering the issuance of additional shares of common stock. The description is of necessity a technical summary of the law relating to rights attendant to ownership and is of little interest to the average investor. Item 6(a) of S-16 allows this to be incorporated by reference to the latest registration statement under Section 12 of the Exchange Act, and we feel that this is a more appropriate way of handling the disclosure. Finally, we feel that Item 14 concerning indemnification is meaningless to investors and should not be included anywhere in the registration statement. If the Commission feels that it needs disclosure of indemnification provisions for its enforcement activity (a contention with which we strongly disagree), such disclosure should not be part of the "simplified" dis-

closure system. We also see no need for a summary of the statutory provisions of state corporation law since these provisions are readily available to the Commission, and the Commission and its staff are familiar with them.

Concerning proposed Form S-2, we suggest that the form clearly indicate whether sections of the annual report to security holders other than those specifically referred to in Item 12(a)(3) are deemed to be incorporated into the prospectus for purposes of Sections 11 and 12 of the Securities Act. Whether the remaining sections of the annual report are so incorporated may influence an issuer's decision which option to follow.

We urge the Commission to consider whether there remains any necessity to retain Form S-8, which has become virtually identical to Form S-16. Employees, other than executive officers who by virtue of their positions may have access to all the information they need to make investment decisions, should be afforded the same disclosure and protections as any other investors. If an issuer is not widely followed, employees need the same information contained in Forms S-1 or S-2 as any other investor. The elimination of Form S-8 would also be beneficial to issuers which have multiple registration statements in effect at one time. U. S. Steel, for example, has two employee stock plans and a dividend reinvestment plan currently in effect. If all three registration statements were prepared on the same form it would allow for certain common sections of the registration statements to be prepared for inclusion in all three and would eliminate the problems associated with insuring that the various registration statements comply with the technical differences which will exist between Forms S-3 and S-8.

Finally, we urge the Commission to expand the transaction requirements of Forms S-2 and S-3 to allow these forms to be used in an exchange offer as well as primary and secondary offerings. In our view an exchange offer by a widely followed issuer is essentially equivalent to a primary offering by such an issuer. In either case the

market possesses sufficient information to evaluate the fair market value of the issuer's security. The efficient market theory upon which the entire program is predicated would appear applicable to exchange offers as well as cash offers. While we recognize and sympathize with the Commission's concerns that an exchange offer, especially one in connection with a tender offer, creates a sense of urgency that mitigates against investors' consideration of material incorporated by reference into a prospectus, we feel that the inclusion of the required information of a Form S-1 prospectus in conjunction with a tender offer produces a document which by its very length discourages reading it. Some combination prospectuses and offers to purchase resemble telephone directories, and we feel that they should be significantly shortened to encourage those they are directed at to read them.

Release Number 33-6332

The integration of the Guides to the Preparation and Filing of Registration Statements into Regulation S-K make a great deal of sense. In our view Regulation S-K, as currently in force, provides adequate disclosure, with the exception of two items discussed below, and we agree with the Commission's decision to leave most of its requirements intact.

We question the necessity of setting forth in Regulation S-K a description of the Commission's policy on projections in the general instructions section. Projections are so closely tied to the safe harbor rules, which are proposed to be amended in Release Number 6338, that it seems logical to treat the entire subject in only one rule, with cross references to it where appropriate. We did find the explanation of the policy to be helpful and would suggest inclusion of the material with the Rules.

We suggest that the Commission consider modifying the wording of the instructions to paragraph (a) of Item

102, Description of Property, to clearly indicate that the disclosure should focus on the materiality of the aggregate mineral reserves to the registrant's business and that disclosure concerning individual properties is appropriate only when such properties by themselves represent a material part of the total assets. We also urge the Commission to mandate use of the terminology adopted by the U.S. Geological Survey in Circular 831. As we have commented previously (see letter of December 30, 1980, File No. 57-853), use by the Commission of the terms "proven", "probable" and "possible" instead of the technically defined terms of "measured", "indicated" and "inferred" adds unnecessary confusion to the disclosure of mineral reserves. As is pointed out in Circular 831, the terms "measured" and "proven" are essentially synonymous but "probable" and "indicated" are not. We also question whether there is any need for a specific limitation on the quality of reserves disclosed. Indeed, we feel that the absolute prohibition of inclusion of inferred reserves may itself be misleading. As the Commission is well aware, the non-disclosure of what were then only inferred reserves was the basis of the *Texas Gulf Sulphur* case. We understand and share the Commission's concern that the disclosure of inferred reserves may be misleading if the reader does not understand the nature of such reserves. In U. S. Steel's latest 10-K, we responded to this concern by including a definition of the terms that were used in describing mineral holdings. We feel that the Commission can best protect the public by insisting upon the use of the correct description of all material reserves. Finally, we suggest that the Commission consider whether circumstances still warrant treating oil and gas reserves differently from other reserves.

We have already commented on the Commission's proposed amendments to its rules concerning the disclosure of environmental proceedings (see letter dated August 28, 1981, File S7-884) and, therefore, we will not repeat those

comments in response to proposed Item 103. We would, however, emphasize that in our view the mandated disclosure of masses of trivial information regarding inconsequential environmental proceedings obscures important disclosure and reduces many of the benefits otherwise to be gained through the simplification inherent in the integrated disclosure purpose.

We suggest that the Item 201(c), Dividends, or the related instructions clearly indicate that restrictions on ability to pay dividends does not include the general requirement of statutory corporation law that dividends be paid out of surplus or profits.

Instruction 5 to Item 301, which presents detailed rules concerning the computation of the ratios of earnings to fixed charges, is a new addition to the Selected Financial Data item. The instruction should indicate that presentation of these ratios remains optional with the registrant.

Since we presented our views concerning Items 402 and 403, Management Remuneration, in response to the Commission's recent proposals (see letter of May 15, 1981, File S7-879), we will not repeat them here.

While we agree with the substantive provisions of Item 502, we question the necessity and the practicality that this information be presented on the inside front cover, or in some cases the outside back cover of the prospectus. As stated earlier in this letter concerning Item 2 of Form S-3, this information more properly belongs in the body of the prospectus. We also question, in those cases where several of the subitems would all be applicable, whether all of the required material could be accommodated on the inside front cover, consistent with the Commission's Rules concerning type size, *see* Rules 420 and 12b-12(c).

Concerning Item 510, we would reiterate our position concerning indemnification set forth in response to Release Number 33-6331 above.

Finally, we offer two comments concerning the additions to the Exhibit Requirements, Item 601. First, sub-

item (25) would make the power of attorney forms an exhibit to the registration statement. While we agree that signed copies should be submitted to the Commission, we see no need for these to be exhibits to the registration statement. Subitem (26) requiring as an exhibit a statement that the trustee is eligible and qualified under the Trust Indenture Act of 1939 seems misplaced as an exhibit. We feel that this information should be contained in the trustee's registration under the Trust Indenture Act.

Release Number 33-6333

With two exceptions, the proposed revisions to Regulation C are of a technical nature, and we support the substance of the rules. We do, however, have certain technical and editorial suggestions concerning some of the rules. We have strong reservations concerning Rules 411 and 418 dealing with the impact of incorporation by reference of previously filed documents on the liability provisions of the Securities Act. We feel it more appropriate to make our comments on these rules in connection with Release Number 6337 which more directly deals with this issue.

Rule 405(i) defining dividend reinvestment plans perhaps should be modified to include in the definition plans where a corporation pays brokerage, administration and custody costs. Under the current Internal Revenue Service interpretation of the tax law applicable to such plans, payment of such costs by the company must be prorated to each participant as additional dividend income for tax purposes. Under such plans the participants are deemed to have purchased shares at slightly above the market price since their contribution and cost basis is the pro rata share of all of the purchase prices and the pro rata share of expenses. A literal reading of the proposed definition would exclude such plans from the definition. We would suggest adding the phrase "including plans where the registrant pays fees and expenses for participants" at the end of the definition.

The Commission has requested comments on whether the secretary and treasurer should be listed in the definition of executive officers in Rule 401(m) or be deleted in favor of their coverage where appropriate under the general inclusion of those who perform a policy-making function. We favor the function approach because such titles may not always be representative of a true policy-making role.

Release Number 33-6335

This release, dealing with the interaction of the liability provisions of the Securities Act and the integrated disclosure system, raises the most important issues to be considered in the development of the integrated disclosure system. Unlike liability under Section 10 of the Exchange Act and Sections 17(a)(2) and (3) of the Securities Act, scienter need not be proven to establish liability under Section 11 of the Securities Act. This difference, coupled with the potential liability exposure of the underwriters, has lead some to place more emphasis on the preparation of registration statements than periodic reports. We agree with and support the concept set forth in the release that the key is whether the prospectus and documents incorporated into it taken as an integrated whole contain all of the required disclosures. To us it seems clear that, if the information in a previously filed document is updated by a subsequently filed document and both are then incorporated by reference into a prospectus, the updating can correct the original information which may have become incorrect or misleading. All of the judicial and administrative decisions reviewing the adequacy of disclosures, whether based upon misrepresentations or omissions, under the federal securities laws have held that the entire document must be examined, not merely isolated sections thereof, when evaluating the adequacy of disclosure.

We do not agree with the provision of proposed Rule 412 that, for purposes of Section 11(a), an incorporated by reference document became effective when it was initial-

ly filed. While this would appear to be the only feasible approach for documents (such as 10-Q reports) which are prepared and filed after the registration statement became effective, a different rule should apply for documents that were initially filed prior to the registration statement becoming effective. The point we are making can best be illustrated by the following example. Assume that a company reports in its 10-K that as of December 31 it owned property containing 10,000,000 tons of silver reserves. This statement was inaccurate because only 8 million tons were economically recoverable and thus, 2 million tons should not have been classified as reserves. On July 1 a registration statement became effective and, due to an increase in the market price of silver, as of that date all 10 million tons are economically recoverable. Since the statement is accurate as of the date the registration statement became effective, there should be no liability exposure under Section 11 of the Securities Act. As drafted, the proposed rule suggests that there might be. On a more basic policy level, the rule suggests that in the preparation of registration statements and prospectuses, concentration should be placed on analyzing whether statements in previously filed documents incorporated by reference were accurate when made rather than whether they are complete and accurate at the present time. Therefore, we suggest that the Commission modify the rule so that the effective date of previously filed documents incorporated by reference should be the date of the registration statement's effectiveness. We also suggest that this rule should apply to any liability under Sections 11 and 12 of the Securities Act rather than merely Section 11(a).

Proposed Rule 418 as drafted would require drawing technical distinctions between modification and replacement of statements. While we support the concept of the rule, we would suggest that the rule be redrafted to emphasize that all subsequent periodic reports and documents

modify prior reports and documents and that all documents incorporated by reference when read as a whole are the basis upon which disclosure is judged.

Release Number 33-6336

We support allowing the inclusion of securities ratings in prospectuses and registration statements. As a practical matter, the rating may be the single most important item to many investors in deciding whether to invest. Indeed, many state statutes regulate investments by banks, insurance companies and fiduciaries in debt instruments based upon the ratings. Inclusion of them in the prospectus will be a convenience to investors.

Release Number 33-6337

We have no objection or comments on the technical amendments proposed in the various other rules and forms under the Securities Act which are required to conform these rules to the new nomenclature and terminology contained in the proposals set forth in the other releases. We would suggest, however, that the Commission specifically provide for a method to renew currently effective continuous registration statements on Forms S-7 or S-16 on one of the new forms. U. S. Steel, for example, currently has on file an effective registration statement on Form S-16 for its Dividend Reinvestment Plan. Under this registration, the registered shares will not be exhausted during 1981, and we plan to file a post-effective amendment extending this registration for another year in early 1982. We feel that Rule 401(b) of Regulation C is unclear concerning the filing of post-effective amendments when the form has been rescinded. In the case of the S-16, we would suggest allowing for it to be subject to the new S-3 requirements.

Release Number 33-6338

We generally support the proposed modifications of the Exchange Act regulations and forms to conform to the new

integrated proposal system. We have reservations about deleting the requirement that certain reports on Form 8-K be filed within ten days of the end of the month and replacing it with a "promptly" requirement. We feel that the ten-day requirement serves a necessary function as an outside boundary during which such reports must be filed. The promptness requirement creates an unnecessary ambiguity.

We appreciate this opportunity to present our views to the Commission, and if you desire any additional information, please contact me.

Very truly your,

C. G. Schwartz
Secretary & Assistant
General Counsel

Excerpt From SEC Staff Accounting Bulletin 47 (Sept. 16, 1982), *reprinted in* 6 Fed. Sec. L. Rep. (CCH) ¶ 74,211 at 63,944:

b. *Unproved Properties*

Facts: Disclosures of reserve information are based on estimated quantities of proved reserves of oil and gas. *Regulation S-K prohibits disclosure of estimated quantities of probable or possible reserves of oil and gas and any estimated value thereof in any document publicly filed with the Commission.*

Question: What type of disclosures will be permitted by registrants who wish to indicate that some of their properties have value other than that attributable to proved reserves?

Interpretive Response: The Office of Engineering has, for the past several years, suggested to registrants the following form of disclosure for undeveloped lease *acreage*:

> "In addition to proved reserves, the estimated (or appraised) value of leases or parts of leases to which proved reserves cannot be attributable is $xxx."

The registrant should describe the basis on which the estimate was made. *For example, such estimated values are often based on the market demand for leasehold acreage which, in turn, is based on a number of qualitative factors such as proximity to production.* If the disclosed amount is based on an appraisal, the person making the appraisal should be named.

Excerpts from the District Court's Jury Instructions

[Tr. 2644] There are certain laws and regulations that are involved in this case. Let me read portions of them to you.

Section 10(b) of the Securities Exchange Act of 1934 provides in part as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, to use or employ, in connection with a purchase, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission may prescribe.

In connection with Section 10(b) [Tr. 2645] the Commission enacted Rule 10(b)-5, and that provides:

It shall be unlawful for any person, directly or indirectly, by the use or means or instrumentality of interstate commerce, to employ any device, scheme, or artifice to defraud, to make any untrue statement of a material fact, or to omit to state a material fact necessary in order to make the statement made in the light of the circumstances under which they were made not misleading, or to engage in an act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

One more section. Section 14(e) of the Securities Exchange Act of 1934 provides in part:

It shall be unlawful for any person to omit to state any material fact necessary in order to make the statements made in the light of the circumstances under which they are made not misleading in connection with any tender offer or any solicitation of security holders in opposition to or in favor of such offer.

It was the purpose of Congress in passing Section 10(b) and Section 14(b), and it was the purpose of the Securities

Exchange Commission in adopting Rule 10(b)-5, to require a policy of full disclosure.

In light of this standard, before you may [Tr. 2646] find liability upon the defendants, you must find all of the following:

First, that the defendants omitted the alleged fact;

Second, that defendants knew the alleged information at the time, and knowingly and intentionally omitted such facts;

Or, too, that the defendant acted with recklessness;

Third, that the information omitted was material;

Four, that the plaintiffs relied on the documents where the information was omitted;

And five, that those material omissions caused plaintiffs to suffer losses.

Observe: Neither Section 10(b) nor Section 14(e), nor Rule 10(b)-5, imposes any liability for innocent or negligent acts. Liability is imposed only for acts of fraud, recklessness, misrepresentation or omission.

In a situation where an omission to state a material fact is claimed, the plaintiffs are not required to prove reliance. It is incumbent, instead, upon the defendants to establish that there was no reliance.

But defendants have established [Tr. 2647] nonreliance if they prove that even if the Strong Report and the First Boston Report had been disclosed in the tender offer, the results would have been the same.

I used the word recklessness a moment ago as one of the elements. Recklessness is highly unreasonable conduct, which is an extreme departure from standards of ordinary care, and while danger need not be known, it must at least be so obvious that any reasonable man would have known it.

U. S. Steel and Marathon did disclose the Strong and the First Boston Reports in the joint proxy statement which they distributed to the Marathon shareholders dated February 8, 1982, in connection with the proposed merger. That disclosure was made in accordance with Rule 13e-3,

and instructions to Schedule 13(e) of the Securities and Exchange Commission.

I instruct you that the instructions to SEC Schedule 13e were specifically applicable only to the merger transaction, and not to the U. S. Steel tender offer. The inclusion of the reports in the proxy statement relating to the merger does not establish that they should or should not have been disclosed in the tender offer.

Representations concerning future sales, projections, forecasts, and the like, only rise to the level of materiality when they can be calculated with [Tr. 2648] substantial certainty.

Only disclosure of existing material facts is required. Economic forecasts are not.

A failure to make known a projection of future earnings is not a violation of the Federal Securities law.

You must first determine whether the omission of the Strong or First Boston Reports constituted a failure to disclose a material fact.

An omitted fact is material if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to tender his stock.

Supreme Court, U.S.
FILED
FEB 8 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1030

In the Supreme Court of the United States

OCTOBER TERM, 1985

IRVING AND CHARLOTTE RADOL, *et al.*,

Petitioners,

vs.

W. BRUCE THOMAS, *et al.*,

Respondents.

On Writ of Certiorari to the
United States Court of Appeals for the
Sixth Circuit

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1030

IRVING AND CHARLOTTE RADOL, *et al.*

Petitioners,

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W. BRUCE THOMAS, *et al.*

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United States Court of Appeals for the
Sixth Circuit

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Petitioners submit this Reply Brief in Support of Petition for Writ of Certiorari in order to reply to certain contentions by respondents in their Brief for Respondents in Opposition (the "Respondents' Brief"), dated January 15, 1986.

1. Respondents Concede that the Third Circuit's *Flynn* Standard of Materiality is Inconsistent with the "Substantial Certainty" Standard Applied by the Sixth Circuit below.

The district court's charge told the jury that a failure to disclose a projection of future earnings can never be a vio-

lation of Rule 10b-5. The Sixth Circuit agreed and ruled that therefore a directed verdict for respondents should have been entered.

Respondents acknowledge that this *per se* rule is incompatible with *Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978 (3d Cir. 1984). Respondents' Brief, pp. 19 ("multi-faceted 'test' "), 20 ("modified test"), 21 ("multi-factor approach").

Respondents seek to dissipate the force of this conflict by claiming that the decision in *Flynn* "would not be applied to the 1981 events in this case, even in the Third Circuit." Respondents' Brief, pp. 3, 19, 14. This argument is plainly incorrect. Moreover, it disregards the manifest purpose of certiorari, to avoid for the future the clash of inconsistent standards of federal law among the circuits.

In fact, the Third Circuit stated that its "reluctance to apply the new standard for disclosure retroactively *is confined to the facts of this case*." 744 F.2d at 988, n. 19 (italics supplied). This reluctance was due in no small measure to the 8½ year interval from the March, 1976 tender offer to the September, 1984 appellate decision. Indeed, the court felt "constrained by the significant development in disclosure law since 1976 not to apply the announced standard retroactively. . . ." 744 F.2d at 988.

Yet the Third Circuit made abundantly clear that it did "not intend to imply that in other cases based on actions occurring before the date of this opinion, the new standard is necessarily inapplicable." 744 F.2d at 988, n. 19.

There is good reason to believe that, in *this* case, the Third Circuit would have applied *Flynn* and would have found the jury charge to be error. This is particularly so because the district court opinion denying summary judgment to defendants in *Flynn* was published two years before the U.S. Steel tender offer in late 1981. *Flynn v. Bass Brothers Enterprises, Inc.*, 456 F.Supp. 484, 489-493 (E.D. Pa. 1978). The court there held that disclosure of asset appraisals could be material under this Court's decision in *TSC Industries, Inc.*

v. Northway, Inc., 426 U.S. 438 (1976).[1] Therefore, defendants were on notice that asset appraisals could be material well before the tender offer in this case. The Third Circuit standard in *Flynn* would thus apply to this case.

In any event, whether *Flynn* would generally apply prospectively only or retrospectively as well, respondents do not deny that there is a conflict in approaches between the Third and Sixth Circuits. It is the office of the Court's certiorari jurisdiction to review a case such as this because of the decision's likely aid in resolving a single, national standard (Rule 17.1(a)), particularly on a question of federal law which has been decided in a way in conflict with applicable decisions of this Court (Rule 17.1(c)).

2. The Sixth Circuit's *Per Se* Determination that Projections Can Never be Material is Inconsistent with *TSC*.

In *TSC*, this Court held that materiality is a mixed question of law and fact. 426 U.S. at 450. Its determination requires a delicate assessment of inferences best left to the trier of facts. *Id.* By holding that projections of future income and similar projections[2] can never be material under the Federal Securities Laws, the district court and the Sixth Circuit improperly ousted the jury from making the delicate assessment of materiality in this case. The jury below was instructed, *inter alia*, that "[r]epresentations concerning future sales, projections, forecasts, and the like, only rise to the level of materiality when they can be calculated with substantial certainty," that "[e]conomic forecasts are not" required to be disclosed, and that a "failure to make known a projection of future income is not a violation of Rule 10b-5." These state-

1. This was so even if the disclosure included a disclaimer of the appraisals' accuracy or reliability. 456 F.Supp. at 490, 493.

2. The valuations of an oil company's reserves are, as respondents explain, based on a discounted, present value calculation of expected future net revenues to be derived if and when the reserves are pumped out of the ground.

ments foreclose a jury from deciding whether a reasonable investor would view the undisclosed information "as having significantly altered the 'total mix' of information made available." *TSC*, 426 U.S. at 449. The jury below was thus not properly instructed concerning the law.

3. The First Boston Report was *Not* a Selling Document, but in any Event, That and Other Factual Disputes are to be Decided by a Properly Charged Jury.

Respondents' Brief improperly distorts the facts and misleads the Court concerning the differing natures of the two reports at issue.[3]

Respondents assert that the First Boston Report was a selling document. Respondents' Brief, pp. 6, 8, 12. There is no evidence to that effect; to the contrary, the only evidence is that the First Boston Report was prepared to show what an outsider, committing millions of dollars to the research, could glean about Marathon's assets from a careful review and analysis of a multitude of obscure public filings in many states.

As to the in-house Strong Report, by contrast, there was conflicting evidence. Petitioners showed at trial that Marathon employees were instructed to give corporate management their best assessment of the company's actual asset values. Respondents tried to show that top management intended to use the Strong Report, once prepared, as a "selling document."

Respondents' Brief presents the facts in the light most favorable to them. In so doing, respondents begin discussion of certain similarities between the two reports. *See, e.g.*, Respondents' Brief, pp. 6-8. Their continued discussion of only the Strong Report without clear demarcation between it and the First Boston Report is apparently calculated to mislead the reader into assuming that both reports are being discussed when, in truth, the argument pertains only to one. *E.g.*, Respondents' Brief, pp. 8-9. Then the discussion purports to

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3. Respondents did the same thing in their briefs to the Sixth Circuit.

relate to "the Reports" (Respondents' Brief, p. 9) followed by specification only of the Strong Report. *Id.*

Actually, though the Reports reached similar results, they did so by different approaches. Yet, Respondents' Brief misleadingly fails to distinguish between them. In reviewing this case in its present posture, where the facts are genuinely disputed by the parties, this Court should leave to a properly instructed jury the ultimate finding of facts. *TSC, supra.* Moreover, because the Sixth Circuit has upheld the judgment as a directed verdict, the Court is required to view the evidence in the light most favorable to petitioners, the plaintiffs in the district court. *Continental Ore Co. v. Union Carbide Corp.*, 370 U.S. 690, 700-701 (1962) (directed verdict ordered by court of appeals was error; remanded for new trial). It is for a jury, when properly instructed, to weigh contradictory evidence and inferences and to draw the ultimate conclusions as to the facts. *Id.*

In essence, respondents' presentation of the facts is an argument to be made to the jury. The present petition, however, seeks to obtain a new trial in which that jury is correctly charged before resolving the numerous factual disputes.

4. Disclosure of the Strong and First Boston Reports Was Permitted, Not Prohibited, by the SEC.

Respondents argue, in essence, that SEC regulations prohibited the disclosures petitioners demand. The argument is without merit. Worse yet, it turns the Federal Securities Laws on their head.

First, the SEC has determined that asset appraisals (including the very Reports at issue here) are presumptively material in a going-private merger and therefore were required to be disclosed in the February, 1982 proxy statement-prospectus. SEC Rule 13e-3, 17 C.F.R. §240.13e-3. This was the second step of respondents' two-step unitary transaction, after U.S. Steel had already acquired a majority interest in Marathon by use of the tender offer mechanism. Nevertheless, respondents contend that the very same asset appraisals

can *never* be material, as a matter of law, in the first step, the tender offer stage, when the shareholders actually had to decide whether to sell that majority interest to U.S. Steel. This argument is illogical.

The presentation asserts that the materiality of these Reports in the tender offer context must, under *TSC*, be decided on a case-by-case basis and not, as the courts below held, as a matter of law.

Second, respondents ignore the facts in the record that the SEC staff *in fact* permitted the disclosure of estimates of oil and gas reserves other than "proven" reserves. Respondents never sought to introduce any evidence disputing this actual SEC practice. It is reflected in the SEC's official publication. Petition for Writ of Certiorari, at p. A-65.

Third, in this case the respondents knew at the time of the tender offer—and so stated in the offering circular—that a merger vote necessitating the issuance of the proxy statement would be the second stage of their "unitary transaction." Thus, it is reasonable to impose upon them at the tender offer stage the obligation of disclosure under Rule 10b-5 which in any event the SEC considered essential in a merger context. Clearly, the SEC staff would have permitted respondents to make the disclosure at the tender offer stage, since it was going to be made in any event three months later. But neither U.S. Steel nor Marathon sought such permission.

The force of respondents' argument is that they have converted the Federal Securities Laws and SEC regulations designed to protect the *buying* public, into a shield immunizing Marathon and U.S. Steel from disclosing to *selling* investors the most essential information about the value of what they were selling, when U.S. Steel, the buyer, was fully aware of that information. See *Flynn*, 744 F.2d at 987. The policy of the Securities Laws favors full disclosure of such information.[4]

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4. Particularly is this so here. Marathon first told its stockholders to reject the Mobil tender offer because it "does not represent the real values of the assets underlying your investment in Marathon" (boldface deleted) and

5. Projections into the Future are Frequently Employed, Even by the Courts, and Such Use is Reasonable and Material.

The crux of the Sixth Circuit's constriction of the materiality standard announced by this Court in *TSC* is that the circuit court does not believe it "reasonable" for investors to take informed projections into account in making investment decisions. This view, of course, conflicts with the very essence of an investment, which is a future oriented action. Worse, yet, in applying its "substantial certainty" standard to investments, the Sixth Circuit ignored the reality that the courts, like other human institutions, regularly take projections of the future into account.

For example, lost future income is frequently calculated by courts and awarded as non-speculative damages. In *Jones & Laughlin Steel Corp. v. Pfeifer*, 462 U.S. 523 (1983), the Court acknowledged that damages for impaired earning capacity are awarded where "it is assumed that if the injured party had not been disabled, he would have continued to work, and to receive wages at periodic intervals until retirement, disability, or death." 462 U.S. at 533. The damage award "is intended to compensate the worker for the diminution in that stream of income" even though "[t]he lost stream's length cannot be known with certainty. . . ." *Id.* Indeed, although "[t]he probability that [the worker] would still be working at a given date is constantly diminishing" (*id.*), that fact does not preclude a reasonable calculation of lost future income. The courts do not require "substantial certainty" from the expert witnesses who testify about a non-speculative "estimate of what the lost [future] stream of income would have been." 462 U.S. at 536. Nor do courts hold, as did the Sixth Circuit in this case, that economic forecasts can never be material and hence employed.

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because it is an "attempt to seize control of Marathon's assets at a fraction of their value." Then, Marathon recommended acceptance of the competing U.S. Steel tender offer. But, throughout these communications, Marathon never disclosed the information it had as to what the value of the company's assets really was.

These estimates of future events are no less important or material to the outcome of a case merely because we cannot predicate the future with complete accuracy. A "substantial certainty" standard as developed in the Sixth Circuit would, if applied to calculations of future income streams in injury cases, preclude all evidence this Court clearly considered in *Pfeifer* to be essential.

The Court has also observed, in affirming an award of lost future profits, that "every appraisal of damage involving the present value of property involves a predication as to what will occur in the future." *Palmer v. Connecticut R. & Light Co.*, 311 U.S. 544, 559 (1941). The Court there acknowledged it had approved a damage award for lost profits "because 'what is required is not mathematical exactness but only a reasonable approximation. That, after all, is a matter of judgment. . . .'" 311 U.S. at 561.[5]

In a recent decision not yet officially reported, the Ohio Court of Appeals ruled, in the appraisal proceedings arising out of the very tender offer-merger transaction at issue here, that the evidence of net asset value of Marathon was admissible bearing upon the true cash value of all of the shares of the company. The court further found that the evidence indicated that the intrinsic value of Marathon stock at the time of the going-private merger was $163 per share. *Price v. Marathon Oil Company*, Nos. 5-84-4/9 (Ohio Ct. of App., 3d Dist., Jan. 14, 1986).

The jury in this case should have been permitted to consider whether such valuation as contained in the Strong and First Boston Reports was material to the investors' evaluation of the tender offer and going private merger.

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5. Of course, other courts have permitted damage awards based on estimates of future profit or income streams. *E.g., G.M. Brod & Co., Inc. v. U. S. Home Corp.*, 759 F.2d 1526 (11th Cir. 1985) (tortious interference with business relations); *Litton Systems, Inc. v. American Tel. & Tel. Co.*, 700 F.2d 785 (2d Cir. 1983) (antitrust); *Autowest, Inc. v. Peugeot, Inc.*, 434 F.2d 556 (2d Cir. 1970) (Automobile Dealers' Day in Court Act).

CONCLUSION

For all the foregoing reasons and those previously set forth in the Petition for Writ of Certiorari, the Petition should be granted and the case set for full briefing on the merits.

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February 7, 1986

CERTIFICATE OF SERVICE

I, David H. Weinstein, hereby certify that I am a member of the Bar of the Court, that I am one of the attorneys for petitioners on the foregoing brief, and that three copies of the foregoing brief were served on counsel for each respondent by United States mail this date by deposit of same in a United States post office or mail box, first class postage prepaid, addressed to counsel of record at their respective office addresses.

DATED: February 7, 1986 DAVID H. WEINSTEIN

Supreme Court, U.S.
FILED
MAY 28 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1030

In the Supreme Court of the United States

OCTOBER TERM, 1985

IRVING AND CHARLOTTE RADOL, ET AL., PETITIONERS

v.

W. BRUCE THOMAS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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In the Supreme Court of the United States

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v.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is filed in response to the Court's invitation to the Solicitor General to express the views of the United States.

STATEMENT

1. Petitioners brought this class action on behalf of themselves and other former shareholders of Marathon Oil Company (Marathon) against respondents United States Steel Corporation (USS), members of the USS board of directors, and former Marathon directors, alleging violations of the federal securities laws, common law fraud, and breach of fiduciary duty (Pet. App. A-2). This misconduct allegedly

occurred in connection with USS's negotiated acquisition of Marathon pursuant to a friendly cash tender offer commencing in November 1981 for 51% of Marathon's outstanding shares, followed by a March 1982 "freeze-out" merger in which USS acquired the remaining 49% of the Marathon stock in exchange for USS debentures (*ibid.*).

After the district court granted partial summary judgment in favor of respondents,[1] the sole federal securities law claim that remained for trial was petitioners' allegation that respondents had violated general antifraud provisions, Sections 10(b) and 14(e), of the Securities Exchange Act, 15 U.S.C. 78j(b) and 78n(e), and 17 C.F.R. 240.10b-5, by failing to disclose at the time of the tender offer two reports containing valuations of Marathon's assets, the bulk of which were oil and gas reserves (Pet. App. A10-A12, A49-A64). According to petitioners, the omission rendered misleading the tender offer materials disseminated by USS and Marathon to Marathon shareholders in November 1981 (*id.* at A60-A61). Marathon had commissioned the two reports in mid-1981, anticipating that a hostile takeover attempt might be precipitated by the declining market price of its stock (*id.* at A3-A4). The two reports, known, respectively, as the "Strong" and "First Boston" reports, indicated per-share net asset values substan-

[1] The district court rejected, among others, petitioners' contentions that the two-tier acquisition was an unlawful coercive and manipulative device (Pet. App. A53-A56), that respondents' communications at the time of the tender offer amounted to unlawful proxy solicitation (*id.* at A56-A58), and that SEC disclosure requirements applicable to the freeze-out merger applied to the earlier tender offer as well (*id.* at A58-A60). The petition for a writ of certiorari does not present any of these claims.

tially in excess of the current market price of Marathon stock (*id.* at A4). Marathon provided the reports to USS in the course of preliminary merger negotiations, but neither Marathon nor USS revealed the reports to the shareholders during the almost two-month period of the tender offer (*id.* at A6, A8-A9).[2]

The district court found that the two "reports were not prepared in the ordinary course of business. Instead, they were intended to be 'selling documents' for use in attracting more favorable tender offers [than the anticipated hostile bid]" (Pet. App. A50). According to the district court, the calculations used in the two reports "were based on speculation and assumptions which included economic predictions as far as 50 years into the future and projections of the future price of oil" (*ibid.*). The district court nonetheless denied respondents' motion for summary judgment with respect to the lawfulness of respondents' failure to disclose the asset appraisals, holding that the appraisals were not immaterial as a matter of law (*id.* at A62). The court stated that it was "conceivable that a 'reasonable shareholder' would have accorded the valuations 'actual significance' in his deliberations, even if disclosure would not have altered his decision" (*ibid.*, quoting *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976)).

At the conclusion of a four-week trial, the court instructed the jury on, among other issues, the questions of materiality and respondents' duty to disclose

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[2] The reports were subsequently disclosed in the proxy statement issued in February 1982 in connection with the freeze-out merger, as required by the Securities and Exchange Commission. 17 C.F.R. 240.13e-3, 240.13e-100, Item 9. See Pet. App. A9-A10.

the two reports. These instructions included the following:

> Representations concerning future sales, projections, forecasts, and the like, only rise to the level of materiality when they can be calculated with [Tr. 2648] substantial certainty.
>
> Only disclosure of existing, material facts is required. Economic forecasts are not.
>
> A failure to make known a projection of future earnings is not a violation of the Federal Securities Law.
>
> * * * * *
>
> An omitted fact is material if there is a substantial likelihood that a-reasonable person would consider it important in deciding whether to tender his stock.

Br. in Opp. App. 37a. The jury returned a verdict for respondents on the federal securities law claim (and on a state law breach of fiduciary duty claim) (Pet. App. A10-A12).

2. The court of appeals affirmed (Pet. App. A1-A27). The court held (*id.* at A15) that the district court's instructions accurately stated the general test for materiality set forth in *Northway* and the Sixth Circuit precedent governing the duty to disclose asset appraisals. The court added that the lower court erred in allowing the question to go to the jury at all when it was merely "conceivable" that a reasonable shareholder would have found the reports significant.

The court relied heavily on its reasoning in the companion case *Starkman* v. *Marathon Oil Co.*, 772 F.2d 231 (6th Cir. 1985), cert. denied, No. 85-1029 (Feb. 25, 1986), decided the same day and also arising out of USS's acquisition of Marathon. *Starkman*

involved respondents' duty to disclose the Strong and First Boston reports during the period prior to USS's tender offer (Pet. App. A28-A29).[3] In *Starkman*, the court of appeals concluded (*id.* at A14-A16, A37-A47) that the two reports were not sufficiently reliable to meet the materiality standard this Court adopted in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. at 449,[4] as subsequently applied in Sixth

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[3] *Starkman* was a suit by a Marathon shareholder who had sold his shares in the open market before the commencement of the USS tender offer in November 1981 (Pet. App. A28-A29). (The plaintiff class in the present case is comprised of Marathon shareholders who tendered and shareholders who did not tender and were taken out in the subsequent merger.) In *Starkman*, the primary federal securities law claim concerned Marathon's obligation to disclose the two reports and five-year earnings and cash-flow projections in connection with an unsuccessful tender offer by Mobil Oil Company in October 1981 (Pet. App. A29). The court of appeals affirmed the district court's grant of summary judgment, reasoning that the net asset values detailed in the reports, as well as the earnings projections, were consistent with Marathon's statements to shareholders that Mobil's bid was "grossly inadequate" (*id.* at A36-A47). This Court recently denied certiorari in *Starkman* on questions relating primarily to the materiality of preliminary merger negotiations between Marathon and USS. *Starkman* v. *Marathon Oil Co.*, cert. denied, No. 85-1029 (Feb. 25, 1986).

[4] Although this Court in *Northway* defined materiality in the context of an alleged violation of 17 C.F.R. 240.14a-9 governing proxy disclosures (426 U.S. at 448-449), the lower courts have adopted the same definition in cases arising under both Sections 10(b) and 14(e) of the Securities Exchange Act. See, *e.g.*, *Flynn* v. *Bass Brothers Enterprises, Inc.*, 744 F.2d 978, 985 (3d Cir. 1984); *Staffin* v. *Greenberg*, 672 F.2d 1196, 1205 n.10 (3d Cir. 1982); *Panter* v. *Marshall Field & Co.*, 646 F.2d 271, 289 (7th Cir.), cert. denied, 454 U.S. 1092 (1981); *Seaboard World Airlines, Inc.* v. *Tiger Int'l, Inc.*, 600 F.2d 355, 358 n.3, 360-361 (2d Cir. 1979).

Circuit cases dealing with "soft information," [5] a test that the court interpreted as requiring disclosure of "asset appraisals based upon predictions regarding future economic and corporate events only if the predictions * * * are substantially certain to hold" (Pet. App. A45).

In *Starkman*, the court of appeals also examined at length the history of SEC disclosure rules concerning soft information. The court noted that, by the time USS made its offer in November 1981, the Commission's general disclosure policy had evolved from *prohibiting* disclosure of asset appraisals, projections, and other soft information to *permitting*, but not mandating, such disclosure if the supporting assumptions and hypotheses were revealed (Pet. App. A41-A42). The court emphasized (*id.* at A42-A43), however, that at the time of the USS tender offer, Commission Regulation S-K (17 C.F.R. Pt. 229) *prohibited* disclosure of estimates of less-than-proven oil and gas reserves (see pages 11-12, *infra*). While noting that the Commission later modified its regulations

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[5] "Soft information" is a term used to refer to a variety of "statements concerning the future, such as projections, forecasts, predictions, and statements concerning plans and expectations * * * [and] information based primarily on subjective evaluations—for example, representations concerning * * * the appraised value of assets * * *." Schneider, *Nits, Grits, and Soft Information in SEC Filings*, 121 U. Pa. L. Rev. 254, 255 (1972). Accord, L. Loss, *Fundamentals of Securities Regulation* 163-165 (1983) (promises, predictions, estimates, projections, or forecasts); *Guides for Disclosure of Projections of Future Economic Performance*, SA Rel. No. 5992 (Nov. 7, 1978); 43 Fed. Reg. 53246, 53247 n.13 (1978) (management projections of future earnings, sales and net income, planned capital expenditures and financing, corporate business plans and objectives, and statements of dividend policies and capital structure policies).

to permit (but not require) the inclusion of unproven reserve estimates in a target's Commission filings where, as here, the information is provided to the bidder (see pages 12-13, *infra*), the court was "reluctant to impose liability on Marathon for failing to disclose asset appraisals based on hypothetical valuations which the SEC did not then permit to be disclosed in most contexts" (Pet. App. A43). In this regard, the court observed that Section 23(a)(1) of the Securities Exchange Act, 15 U.S.C. 78w(a)(1), precludes the imposition of liability for " 'any act done or omitted in good faith in conformity with a rule, regulation, or order of the Commission' " (Pet. App. A43 (citation omitted)).

The court of appeals then considered whether there existed any "compelling authority" that would overcome the specific Commission prohibition (Pet. App. A43, A44-A46). The court concluded that its precedents not only failed to provide "compelling authority" to require disclosure of the reports, but affirmatively supported nondisclosure of asset appraisals based on predictions not "substantially certain to hold" (*id.* at A45; see *id.* at A14). The court contrasted its approach of examining the reliability of projections underlying asset appraisals with the approach formulated by the Third Circuit in *Flynn* v. *Bass Brothers Enterprises, Inc.*, 744 F.2d 978 (1984) (a case not involving appraisals of oil and gas reserves), under which a district court is directed to weigh the benefits of disclosure against the harm in light of the "totality of the circumstances" in each case (Pet. App. A45-A46).[6]

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[6] Elsewhere in *Starkman*, the court of appeals articulated a different and potentially more stringent version of its materiality standard. See Pet. App. A44 ("soft information such

Applying its test to the predictions underlying the valuations in the Strong and First Boston reports, the court of appeals concluded that these reports were not required to be disclosed in connection with the USS tender offer (Pet. App. A14-A15; see also *id.* at A46).[7] The court stressed in *Starkman* that the estimates contained in the two reports were "based on highly speculative assumptions regarding the path of oil and gas prices, recovery rates and the like over a period of thirty to fifty years" (Pet. App. A46). Absent "an accompanying mountain of data and explanations," the court concluded, "[d]isclosure of such estimated values could well have been misleading" (*ibid.*).

DISCUSSION

The question under what circumstances the antifraud provisions of the federal securities laws may require the disclosure of "soft information" (such as asset appraisals based on projections) is an important one, and the Sixth Circuit's approach to that question in the present case differs, at least in emphasis, from the Third Circuit's approach in *Flynn*. The present case, however, turns in large part on a specific provision, since amended, of Commission regulations governing disclosures relating to oil and gas assets, and the decision below reflects the lower court's view of the particular appraisals at issue.

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as asset appraisals and projections must be disclosed only if the reported values are virtually as certain as hard facts").

[7] The court did not distinguish between the materiality of the information and the duty to disclose it. Only the materiality issue is raised by the petition (see Pet. i). All the parties agree that the disclosure of summaries of the reports was required (and occurred) after the tender offer, in connection with the freeze-out merger. See note 2, *supra*.

Other cases, including future cases in the Sixth and Third Circuits and two cases now pending in other circuits, may present broader, yet more sharply focussed, questions concerning the obligation to disclose soft information. Accordingly, we suggest that the Court deny certiorari here and await a case of more general significance in which to consider such questions.

1. Any liability for nondisclosure of the Strong and First Boston reports would depend on the effect of since-amended Commission regulations applicable only to the oil and gas industry. As the court of appeals observed (see page 6, *supra*), the Commission's policy concerning disclosure of soft information has evolved over the past 15 years. By the time of the USS tender offer, the Commission had shifted from discouraging the inclusion in Commission filings of appraised asset valuations and other future-oriented data [8] to encouraging public disclosure of

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[8] Traditionally, the Commission had viewed the risks stemming from disclosure of possibly over-optimistic management predictions of company performance as outweighing the benefits to be derived therefrom by investors, given the perceived unreliability of appraisals and projections, their potential for misleading investors, and the lack of sufficient Commission resources to evaluate their reliability in each case. See, *e.g.*, *Union Pac. R.R.* v. *Chicago & N.W. Ry.*, 226 F. Supp. 400, 408-409 (N.D. Ill. 1964) (discussing Commission's traditional approach); see generally L. Loss, *supra*, at 163; SA Rel. No. 5992 (Nov. 7, 1978); 43 Fed. Reg. 53246, 53246-53247 (1978); House Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess., *Report of the Advisory Committee on Corporate Disclosure to the SEC* 347-349 (Comm. Print 1977); see also *Flynn* v. *Bass Brothers Enterprises, Inc.*, 744 F.2d at 985-987; *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1294 (2d Cir. 1973). For example, the Commission long took the

such data.[9] This evolution in Commission policy resulted from empirical findings that such "information is important to an investor's assessment of a

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position, now abandoned, that issuers whose securities were in registration should not make any projections, predictions or estimates with respect to income, earnings, or the value of the securities. SA Rel. No. 5180 (Aug. 16, 1971); 36 Fed. Reg. 16506, 16507 (1971).

[9] Beginning in 1973, the Commission undertook a thorough reexamination of its traditional position disfavoring the dissemination of soft information to investors. See *Gerstle* v. *Gamble-Skogmo, Inc.*, 487 F.2d at 1294; SA Rel. No. 5362 (Feb. 2, 1973); 38 Fed. Reg. 7220 (1973). After publishing a series of rule proposals in 1975 relating to projections of future economic performance, see, *e.g.*, SA Rel. No. 5581 (Apr. 25, 1975); 40 Fed. Reg. 20316 (1975), the Commission announced in 1976 that its long-standing policy may have contravened investors' interest in securing predictive information, and that it therefore would not object to the disclosure in public filings of projections of future economic or corporate performance, so long as they were made in good faith, had a reasonable basis, and were accompanied by information sufficient to permit informed investment decisions. SA Rel. No. 5699 (Apr. 23, 1976); 41 Fed. Reg. 19986 (1976). See *Flynn* v. *Bass Brothers Enterprises, Inc.*, 744 F.2d at 987. Two years later, the Commission issued a statement encouraging voluntary disclosure of management projections, based on the "significance attached to projection information and the prevalence of projections in the corporate and investment community." SA Rel. No. 5992 (Nov. 7, 1978); 43 Fed. Reg. 53246, 53247 (1978). To further its goal of encouraging disclosure of future-oriented information, the Commission adopted a "safe harbor" for issuer statements projecting such "forward-looking" items as income, earnings per share, and other indicia of future economic performance, and describing plans and objectives for future operations. SA Rel. No. 6084 (June 25, 1979); 44 Fed. Reg. 38810 (1979) (codified at 17 C.F.R. 230.175, 240.3b-6). The Commission has even mandated disclosure of appraisals in certain situations. Regulation

corporation's future earning power and may be material to informed investment decisionmaking." *Guides for Disclosure of Projections of Future Economic Performance*, SA Rel. No. 5992 (Nov. 7, 1978); 43 Fed. Reg. 53246, 53247 (1978) (footnote omitted).[10]

However, the disputed asset appraisals here were based principally on the value of Marathon's oil and gas reserves, a type of soft information that has been singled out by the Commission for special regulatory treatment because of factors unique to the oil and gas industry.[11] While the USS tender offer was pend-

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240.13e-3 promulgated in 1979, requires that asset appraisals received by the issuer and material to the transaction be disclosed to shareholders in connection with "going private" mergers. SA Rel. No. 6100 (Aug. 2, 1979); 44 Fed. Reg. 46736 (1979). The Commission in 1980 issued a release reflecting the staff's insistence upon the disclosure of good-faith appraisals made on a reasonable basis in proxy contests where the principal issue is the liquidation of all or a portion of the issuer's assets. SA Rel. No. 16833 (May 23, 1980); 45 Fed. Reg. 36374 (1980).

[10] The Commission's current approach toward disclosure of soft information generally is reflected in a policy statement "encourag[ing] the use * * * [in Commission filings and annual reports to shareholders] of management's projections of future economic performance that have a reasonable basis and are presented in an appropriate format." 17 C.F.R. 229.10(b).

[11] When adopting, in 1978, special rules governing financial accounting and reporting practices for oil and gas-producing activities, including required disclosure of proven reserve appraisals, the Commission emphasized that reporting requirements imposed on oil and gas companies were necessarily industry-specific:

> The Commission's determinations published in this release * * * are unique in many respects. They reflect the requirements of the Energy Policy and Conservation Act of 1979 * * *, which directs the Commission to assure the

ing, as the *Starkman* decision points out (Pet. App. A42-A43; seee pages 6-7, *supra*), Commission Reg. ulation S-K directed that "[e]stimates of oil or gas reserves other than proved * * * *shall not be disclosed* in any document publicly filed with the Commission * * *" (emphasis added).[12] The Commission

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development and observance of accounting practices to be followed in the preparation of accounts by oil and gas producers, as well as characteristics peculiar to the oil and gas industry.

SA Rel. No. 5966 (Aug. 31, 1978); 43 Fed. Reg. 40688, 40689 (1978); see *id.* at 40712-40719 (amending Regulation S-X, 17 C.F.R. Pt. 210).

[12] 17 C.F.R. 229.20, Instruction 4 to Item 2(b) (1981); see SA Rel. No. 6008 (Dec. 19, 1978); 43 Fed. Reg. 60418, 60420 (1978) (codified at 17 C.F.R. 229.20, Instruction 4 to Item 2(b) (1979)). The term "reserves" refers to oil or gas not yet extracted for which there is reason to believe production is feasible. *Sunray DX Oil Co.* v. *Helmerich & Payne, Inc.*, 398 F.2d 447, 450 (10th Cir. 1968). As defined by the Commission, "[p]roved oil and gas reserves are the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made" (17 C.F.R. 210.4-10(a)(2)). Estimates of the values of "probable," "potential" and "exploratory" reserves are those premised on more cursory geological and engineering data, and therefore are far less reliable than estimates of proven reserves. See *Del Noce* v. *Delyar Corp.*, [1976-1977] Fed. Sec. L. Rep. (CCH) ¶ 95,670, at 90,293 n.6 (S.D.N.Y. July 30, 1976).

The Commission had long espoused the view that "investors unfamiliar with the technical aspects of the oil and gas business—and these would likely include most shareholders of major oil companies * * *—would ignore or misconstrue the technical but extremely significant difference between 'proved' and 'probable' oil reserves." Brief of the Amicus Curiae SEC

later amended Regulation S-K to permit disclosure of estimates of less-than-proven oil and gas reserves where, as here, these estimates were "provided previously to a person * * * that is engaged in an acquisition of the [company] or its equity securities." SA Rel. No. 6383 (Mar. 3, 1982); 47 Fed. Reg. 11380, 11406 (1982) (codified at 17 C.F.R. 229.102, Instruction 5). See 17 C.F.R. 210.4-10(k)(5)-(6). In 1981, however, such disclosure was prohibited.

Section 23(a)(1) of the Securities Exchange Act, 15 U.S.C. 78w(a)(1), provides that the liability sections of the Act do not apply to "any act done or omitted in good faith in conformity with a rule, regulation, or order of the Commission." The Strong and First Boston reports both included, and based their valuations in part on, estimates of less-than-proven reserves. Although there was no finding with respect to good faith, the court of appeals based its decision in *Starkman*, on which it relied in *Radol*, in part on Section 23(a)(1) together with the then-existing prohibition in Regulation S-K (Pet. App. A43.)[13] The de-

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at 5, *Sunray DX Oil Co.* v. *Helmerich & Payne, Inc.*, 398 F.2d 447 (10th Cir. 1968); see SA Rel. No. 6008 (Dec. 19, 1978); 43 Fed. Reg. 60418, 60420 (1978). As one court explained, "estimating probable [or possible or exploratory] reserves involves excessive speculation and guesswork. Recognize experts disagree as to the proper methods to be used." *Del Noce* v. *Delyar Corp.*, [1976-1977] Fed. Sec. L. Rep. at 92,294. See *Sunray DX Oil Co.* v. *Helmerich & Payne, Inc.*, 398 F.2d at 450-451; *Resource Exploration* v. *Yankee Oil & Gas, Inc.*, 566 F. Supp. 54, 62-64 (N.D. Ohio 1983).

[13] Several months before the USS tender offer, as petitioners point out (Pet. 25-29; see Pet. App. A65-A66), the Commission invited public comment on two amendments to Regulation S-K that would have permitted disclosure of unproven reserves, either in general, with appropriate qualification, or when the

cision below, therefore, turns to a substantial extent on a rule applicable only in the past and only to this particular industry.

2. The decision below also appears to rest in significant part on the court of appeals' view of the particular asset appraisals at issue here. The court described them as "based on highly speculative assumptions" (Pet. App. A46; see *id.* at A4-A6, A30-A32), and said that disclosure of the appraisals could well have been misleading without "an accompanying mountain of data and explanations" (*id.* at A46). Accordingly, while the court of appeals' opinions suggest several different approaches to the disclosure question, the court of appeals' decision below may rest so substantially on the court's assessment of the reliability of these particular appraisals, in light of the historical and factual context in which they were made, as to limit sharply the significance of the decision and render it an inappropriate vehicle for examination of the materiality of soft information generally.[14]

3. The "substantial certainty" test announced by the court below may or may not conflict with the test announced by the Third Circuit in *Flynn*, depending on how the two are interpreted in the respective circuits. The Third Circuit's "totality of circumstances"

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omission of these data would have rendered a document materially misleading. SA Rel. No. 6332 (Aug. 12, 1981); 46 Fed. Reg. 41925 (1981). As the Commission explained, the latter amendment simply would have codified staff practice (*id.* at 41930; see Staff Accounting Bulletin No. 47 (Sept. 16, 1982); 47 Fed. Reg. 41727 (1982) (discussing staff practice). The Commission subsequently withdrew both proposed amendments. SA Rel. No. 6383 (Mar. 3, 1982); 47 Fed. Reg. 11380 & n.2 (1982).

[14] We, of course, express no view as to the reliability of the appraisals at issue in this case.

test for required disclosure of soft information has never been applied: in *Flynn*, the Third Circuit determined that federal securities law did not, as of the time of the tender offer at issue (1976), require disclosure of two reports, including an asset appraisal (744 F.2d at 988-991); the court announced its new test prospectively only (*id.* at 988). Until the two circuits have both applied their potentially disparate tests in concrete factual circumstances, any conflict remains, in our view, largely theoretical.[15]

In *Northway*, this Court held that an omitted fact is material when there exists "a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder * * *," or "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" (426 U.S. at 449 (footnote omitted)).[16] This Court has not yet expressly

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[15] Several factors suggest that any ostensible conflict between the general principles articulated by the two circuits could well prove illusory. The *Starkman* court expressly referred to the disclosure prohibition in Regulation S-K in reaching its decision (Pet. App. A42-A43); the *Flynn* court, on the other hand, was not presented with the oil and gas reserves question, and relied (744 F.2d at 985-988) upon the Commission's general policy of encouraging soft information disclosure. In *Starkman*, moreover, the court of appeals expressly recognized how the Commission's general policy on soft information disclosure has liberalized in recent years (Pet. App. A41; see page 6, *supra*). The Sixth Circuit may take an approach similar to that outlined in *Flynn* and permit a lesser degree of certainty outside the area of oil and gas reserve disclosures.

[16] The Court in *Northway* found these assessments to be "peculiarly ones for the trier of fact," holding that the ques-

considered the application of that standard to soft information.[17] The test articulated by the court below, which would require substantial certainty in the pro-

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tion of materiality must be submitted to the jury unless the omitted information is " 'so obviously important to an investor, that reasonable minds cannot differ on the question' " (426 U.S. at 450, quoting *Johns Hopkins University* v. *Hutton*, 422 F.2d 1124, 1129 (4th Cir. 1970); see *id.* at 450 n.12). Of course, just as information may be "so obviously important" that resort to a jury is not necessary, jury consideration may be unnecessary because the information is "so obviously unimportant."

[17] In *Northway*, 426 U.S. at 454-460, a target corporation had omitted from its proxy statement an investment banking firm's projection of a decline in the market value of securities to be received by shareholders of the target. The Court considered whether this omission was material and rendered misleading a representation in the target's proxy statement that shareholders would receive a substantial premium over market value. The Court declined to rule, as a matter of law, either that the proxy statement misled shareholders or that the information omitted was material, concluding instead that "[t]hese are questions * * * best left to the trier of fact" (*id.* at 460). The Court did not expressly consider how the "softness" of the information might bear on its materiality. Several lower courts, in assessing the materiality of predictive information, have weighed both the magnitude of the future event and the probability of its occurrence. See, *e.g.*, *SEC* v. *MacDonald*, 699 F.2d 47 (1st Cir. 1983); *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969). See also *Smallwood* v. *Pearl Brewing Co.*, 489 F.2d 579 (5th Cir.), cert. denied, 419 U.S. 873 (1974); *Sonesta Int'l Hotels Corp.* v. *Wellington Associates*, 483 F.2d 247 (2d Cir. 1973). The materiality test proposed by the Third Circuit in *Flynn* appears to require a determination of the reliability of the soft information and a balancing of the relative benefits and risks to investors of disclosure (see 744 F.2d at 988).

jections underlying soft information, may be inconsistent with *Northway*, but because of the circumstances described at pages 9-14, *supra*, that question is not squarely presented in this case.

Finally, we note that two cases raising the general question of the materiality of soft information are now pending before the Fourth and Seventh Circuits.[18] Decisions in these cases may influence future decisions in the Third and Sixth Circuits, and may provide the Court with a better vehicle to resolve the issue should a conflict develop.

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[18] *Walker* v. *Action Industries, Inc.*, CA No. 84-720-A (E.D. Va. Mar. 27, 1985), appeal pending, No. 85-1407 (4th Cir.) (claim that omission of internal sales forecasts rendered tender offer materials misleading); *Dixon* v. *Ladish Co.*, 597 F. Supp. 20 (E.D. Wis. 1984), appeal pending, No. 85-1300 (7th Cir.) (claim that omission of internal asset appraisals rendered proxy materials misleading).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1986

☆ U. S. GOVERNMENT PRINTING OFFICE: 1986 491507 20226